CONSUMER USE OF TAX REFUND ANTICIPATION LOANS

Credit Research Center
Monograph #37

April 2005

Gregory Elliehausen
Senior Research Scholar
Credit Research Center
McDonough School of Business
Georgetown University

The Credit Research Center

The Credit Research Center was founded in 1974 by Robert W. Johnson, Professor of Finance at Purdue University's Krannert Graduate School of Management. The Center's founding was an outgrowth of Dr. Johnson's service as presidential appointee to the National Commission on Consumer Finance in 1969. During its 3-year term, the Commission coordinated a massive research program to study the operation of consumer credit markets in the United States. Delivered to Congress in 1972, the Commission's multi-volume report established the value of academic research for guiding public policy toward markets for financial services. With a combination of foundation and corporate grants, Dr. Johnson established the Credit Research Center at Purdue University to provide an ongoing means of directing academic research expertise toward practical problems in consumer and mortgage credit markets.

Over the past thirty years, the Center has gained a national reputation for its work in evaluating the impact of public policy on credit markets. Throughout its history, the Center's research program has been supported by a mix of grants from the public sector and unrestricted private sector grants from foundations and corporations made to its host University on behalf of the Center. Over one hundred articles and monographs by distinguished scholars document its research product. The Center's senior research staff members have frequently testified before Congress and state legislatures on such topics as Truth in Lending disclosures, the impact of interest rate ceilings on credit availability, equal credit opportunity regulations, personal bankruptcy, credit insurance, credit scoring, and the impact of privacy regulations. Recent research has examined credit counseling and debt repayment plans, demand for credit and usage patterns, regulation of pricing in credit markets, and credit reporting. The value of these contributions to rational discourse stems from CRC's academic affiliation, rigorous external review of its research, and the years of research experience of its principal researchers and authors.

In July of 1997, Director Michael Staten relocated the Center's offices to Georgetown University in Washington, D.C. The Center is a non-profit unit of the McDonough School of Business where it continues its tradition of non-partisan academic research and education on economic issues relating to consumer credit and markets for retail financial services. For more information about the Center and its publications visit its website at *www.msb.edu/prog/crc*.

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Senior Research Scholar
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***E-mail*:elliehag@msb.edu**

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EXECUTIVE SUMMARY

A tax refund anticipation loan is a short-term loan to a consumer that is based on the amount of the consumer's tax refund. The consumer receives an amount up to the refund amount less the loan fee, tax preparation, and other fees. The refund anticipation loan and fees are normally repaid by the tax refund.

Refund anticipation loans ranged from $200 to $7,000 in 2004, and the loan fee ranged from $10 to $100 depending on the size of the loan. The term of a refund anticipation loan depends on the time the Internal Revenue Service takes to process the refund claim. The term of refund anticipation loans is generally between ten to fourteen days. Because the loan term is short and the fee is large relative to the size of the loan, annual percentage rates for a refund anticipation loans are relatively high. Assuming a ten-day term to maturity, a $3,000 refund anticipation loan having a loan fee of $89, for example, would have an annual percentage rate of interest of 108.28 percent.

The refund anticipation loan is controversial in large part because of its relatively high cost. Critics of the product contend that refund anticipation loans are harmful, and that consumers often do not make informed decisions. Critics have recommend price ceilings or outright prohibition of the product. Suppliers argue that refund anticipation loans provide benefits to some consumers. To assess these arguments, empirical evidence on consumers' behavior is required. Little empirical evidence is currently available.

Purpose of the Study

This study provides empirical evidence on (1) the characteristics of consumers who use refund anticipation loans, (2) why they obtain refund anticipation loans, and (3) what they understand about these loans. Data are from surveys of consumers conducted in March and April of 2004 that question refund anticipation loan customers about the refund anticipation loans they obtained in 2004 based on their 2003 tax returns. The study uses an economic model of the credit decision and a psychological model of the decision process as a framework for analysis of consumers' use of refund anticipation loans.

Findings

The economic model focuses on the outcome of decisions. The model predicts that some consumers may benefit from relaxation of limits on the amount they can borrow, even if they pay a high cost to obtain the additional credit. Such consumers tend to be in early stages of the family life cycle. They are young and have children. Their stock of household durables may be relatively low, and returns on additional household investment may be high. Consumers in this situation often seek to borrow to finance the acquisition of additional household investment, but their ability to borrow may be constrained by their limited current resources. Most credit products are not intended to allow a consumer to borrow fully against an uncertain future income. However, there are a few high cost products that permit borrowing beyond customary limits. The refund anticipation loan, which permits a consumer to borrow against an expected tax refund, is such a product. One would expect that refund anticipation loan customers would be largely from the credit constrained group.

Consistent with the predictions of the economic model, by far most refund anticipation loan customers in 2004 were in early life-cycle stages in which returns on household durables and consequently demand for credit are high. Furthermore, refund anticipation loan customers were generally in lower or moderate income groups, which have limited resources for servicing additional debt. They disproportionately had incomes in lower middle-income groups between \$15,000 and \$39,999. In contrast, refund anticipation loan customers were less than proportionately represented in upper middle and higher income groups that typically are not credit constrained.

An examination of refund anticipation loan customers' use of other types of credit supports the conclusion that many refund anticipation loan customers' access to additional credit is limited. Customers typically fell into one of two groups. The first group consists of consumers who were more likely to use closed-end consumer credit and have higher consumer debt payments relative to income than all households. Relatively high debt-payment burdens may limit these customers' access to additional credit. The second group consists of customers who did not have a bank account. Customers without a bank account may have difficulty qualifying for credit at many lenders.

Refund anticipation loan customers were less likely than other consumers to have open-end bank credit card accounts against which they can borrow at their discretion. A considerable percentage of customers who had bank credit cards reported that there were times during the last year when they did not use their bank credit cards because they would have exceeded their credit limits. Thus, open-end credit may not be an option for short-term borrowing.

About a quarter of refund anticipation loan customers had serious delinquencies on mortgage or consumer debts in the previous year, a characteristic that limits access to credit. Nearly half of customers had been turned down or offered less credit than they had applied for in the previous five years. About half of customers thought about applying for credit but did not because they thought that they would be turned down. The incidence of serious delinquency, loan turndowns or limitations, and perceptions of limitations is much higher among refund anticipation loan customers than the population as a whole.

In sum, refund anticipation loan customers generally have life-cycle characteristics and income that are associated with credit rationing. Their credit market experiences indicate that many customers are indeed constrained. Economic theory predicts that such consumers may benefit from a relaxation of credit constraints. Many such consumers turn to a variety of high-cost credit sources for the additional credit. Survey responses do not allow one to determine whether these customers made utility-increasing decisions. However, there are plausible circumstances in which the net present value of a refund anticipation loan would be positive and, therefore, utility increasing. Refund anticipation loan customers are not very often from groups that economic theory predicts would not benefit from use of high-cost credit.

The psychological model focuses on the process of decision making. Decision making is a multiple step process involving problem recognition, information gathering, choice, and outcome evaluation. Many factors influence the influence extent of this process. These factors include circumstances of the situation, product characteristics, consumer characteristics, and environmental influences. Decisions tend to be extended when the consumer has little previous experience or knowledge of the product, the consumer perceives no immediate need for the product, and the product is relatively expensive or commits the consumer for a long period of time. In contrast, the decision process tends to be limited when the consumer is satisfied with past experience with the product, the consumer perceives an urgent need for the product, or the price of the product is low relative to the consumer's income. Consumers with college educations tend to have more extended decision processes than consumers with less than college educations.

Although many refund anticipation loan customers provide evidence of deliberation in their decision to use a refund anticipation loan, a large percentage of customers appear to have used a limited decision process. As mentioned, circumstances of the situation, product characteristics, and consumer characteristics all may contribute to limited decision processes.

By far most refund anticipation loan customers used the refund anticipation loan to resolve a specific problem, usually an urgent problem such as paying bills or making an unplanned purchase. A perception of urgency may incline many of these customers to a limited decision process. A small percentage of customers used refund anticipation loans to make a planned purchase. Another small percentage of customers did not mention a specific problem that the refund anticipation loan was intended to resolve. Customers not mentioning a specific problem gave not wanting to wait for their money as the primary reason for getting a loan.

Characteristics of the refund anticipation loan may also contribute to a limited decision process for some consumers. The dollar amount of the refund anticipation loan fee is low relative to most customers' monthly income and relative to the larger loan amounts. For a relatively small dollar fee customers can obtain a loan to resolve a problem. The debt is then normally liquidated after a short period of time without effort by the customer.

In many cases, the decision to obtain a refund anticipation loan may have become routinized. Seventy percent of refund anticipation loan customers in 2004 had also obtained refund anticipation loans in previous years. By far the greater percentage of these customers had three or more refund anticipation loans. High satisfaction with the most recent loan in 2004 loan suggests that these customers likely were also satisfied with refund anticipation loans in previous years. By far most of refund anticipation loan customers were satisfied with the most recent loan. Consumers having ample previous experience and satisfaction with that experience often make subsequent decisions with little or no information gathering or deliberation.

Consumers do receive information on the cost of refund anticipation loans and options for receiving funds from tax refunds. Nearly all customers said that their tax preparation service offered electronic filing, and nearly two-thirds discussed alternatives for obtaining funds from refunds faster before obtaining a refund anticipation loan. About half of customers reported an amount of loan fee that suggests that they were aware of the dollar cost of their refund anticipation loan. Most customers recalled other information about the transaction, such as loan and cash advance amounts, or whether other fees were deducted from the loan amount. Thus, many customers provided evidence suggesting consideration of information and deliberation in their refund anticipation loan decisions.

Responses of other customers suggest that a large percentage of refund anticipation customers may not proceed with much information search or deliberation in choosing a refund anticipation loan. About half could not recall the refund anticipation loan fee or reported an amount that was probably too low to be accurate. Many of these customers reported other information about the transaction, such as the tax preparation fee, the amount of the loan, or the amount received. About a third of those not recalling a refund anticipation loan fee reported both loan and cash advance amounts. Customers not recalling the loan fee received information on fees and may have considered fee information in their decisions. However, their inability to recall this information suggests that the refund anticipation loan fee likely was not a very important consideration in their decision.

If a lack of awareness of the cost is a problem for some refund anticipation loan customers, the problem is not unique to the refund anticipation loan product. About half of refund anticipation loan customers with bank credit cards were unaware of the annual percentage rate for their most frequently used bank card. Refund anticipation loan customers' awareness of loan costs likely reflects the characteristics of consumers who obtain refund anticipation loans rather than availability or comprehensibility of information. Refund anticipation loan customers disproportionately have less than 12 years education or a high school diploma, education levels that previous research indicates have lower awareness of credit costs generally than consumers overall.

Concern about levels of awareness of refund anticipation loan fees may be mitigated by several considerations. First, refund anticipation loan customers typically are credit constrained. Economic theory indicates that for such borrowers the cost of forgoing current consumption or using precautionary holdings of liquid assets may be the appropriate discount rate for evaluating consumption/investment decisions. If the cost of credit is not used in making a decision, the cognitive model of the decision process suggests, the information may not be retained in memory. Second, many customers also obtained refund anticipation loans in previous years, most often more than once. Previously satisfied borrowers may be in a position to make decisions without information gathering or deliberation. Again, if borrowers do not use the cost information in their most recent decision they may not retain the information. Finally, information about refund anticipation loan fees and alternatives for filing and obtaining funds faster is readily available. Customers were aware of the availability of electronic filing; and most customers, including customers not recalling the loan fee, discussed with the tax preparer alternatives for obtaining funds faster. Hardly any refund anticipation loan customers perceived unclear or insufficient information or hidden fees as problem.

CHAPTER 1
TAX REFUND ANTICIPATION LOANS

A tax refund anticipation loan is a short-term loan to a consumer that is based on the amount of the consumer's tax refund. The consumer receives an amount up to the refund amount less the loan fee. The proceeds of the refund anticipation loan may be paid by check, deposited in a bank account, or disbursed through a prepaid cash card, within one to three days of filing the tax return.[1] The refund anticipation loan and fee are normally repaid by the tax refund.

Refund anticipation loans are typically arranged through a tax preparation service—such as H&R Block, Jackson Hewitt, and a large number of smaller tax preparers—which acts as a middleman between the borrower and the lender. The lender makes the credit decision and funds the loan. Lenders with large refund anticipation loan programs include Bank One, HSBC Bank, Santa Barbara Bank & Trust, Republic Bank & Trust, and River City Bank.

1-1. Characteristics of Refund Anticipation Loans

Refund anticipation loans range from $200 to $7,000. Lenders may make loans up to the amount of the claimed refund. However, some lenders limit the loan amount regardless of the size of the refund or lend only up to a specific percentage of the refund amount if they have had no previous experience with the customer. The refund anticipation loan fee ranges from $10 to $100 depending on the size of the loan.[2] Table 1-1 shows a fee schedule for refund anticipation loans from one large lender.[3] The term of the loan depends on the time the Internal Revenue Service takes to process the refund claim. The term of the loan is generally between ten and fourteen days.

Table 1-1
Refund Anticipation Loan Fee Schedule
(Dollars)

Loan amount	Fee
$200-499	34
$500-999	49
$1,000-1,499	59
$1,500-1,999	74
$2,000-5000	89

Source: Bank One. www.autotax.com/BankOne.htm, January 13, 2004.

[1] Customers usually receive funds from a refund anticipation loan within a day of filing the tax return.
[2] Other fees such as electronic filing and deposit account setup fees may be charged in conjunction with a refund anticipation loan. Whether or not such fees are included in the finance charge depends on circumstances. For discussion, see section 1-4 below.
[3] Fee schedules for HSBC Bank, Santa Barbara Bank & Trust, Republic Bank & Trust, and River City Bank can be found at these banks' web sites. Fees charged in 2005 may differ from those charged in 2004.

The Federal Reserve Board's Regulation Z defines the annual percentage rate as the periodic rate multiplied by the number of periods in a year (see section 1-4 below). Because of the loan term is short and the fee is large relative to the size of the loan, annual percentage rates for a refund anticipation loans are relatively high. Consider, for example, a $2,000 refund anticipation loan having a loan fee of $89, which is 4.45 percent of the loan amount. If the loan is outstanding for 10 days, the annual percentage rate would be 4.45 percent multiplied by 365/10 = 36.5 periods per year, or 162.43 percent. Table 1-2 illustrates the variation in annual percentage rates for selected loan sizes and loan maturities, based on the fee schedule in table 1-2. The table shows that the annual percentage rate varies inversely with loan amount and the length of the loan term. In practice, lenders usually disclose an annual percentage rate based on a ten or eleven-day term to maturity.

Table 1-2
Annual Percentage Rates for Refund Anticipation Loans,
By Loan Amount and Loan Term
(Percent)

		Loan term (days)					
Loan amount	Fee	10	12	14	16	18	20
$300	$34	413.67	344.72	295.48	258.54	229.81	206.83
$750	$49	238.47	198.72	170.33	149.04	132.48	119.23
$1,250	$59	172.28	143.57	123.06	107.68	95.71	86.14
$1,750	$74	154.34	128.62	110.24	96.46	85.75	77.17
$2,000	$89	162.43	135.35	116.02	101.52	90.24	81.21
$4,000	$89	81.21	67.68	58.01	50.76	45.12	40.61

1-2. Underwriting and Risk

A refund anticipation loan is not risk free. The borrower is obligated to repay a refund anticipation loan but may not receive all or part of the anticipated refund, which is expected to repay the loan.[4] The Internal Revenue Service may reduce a request for a refund for any number of errors or omissions in the borrower's tax return. The Internal Revenue Service may also apply funds from a refund to offset unpaid federal income tax obligations from previous years, student loans, other federal agency debts, state taxes, or child support. On electronic filings, the Internal Revenue Service will provide notice of the existence of an offset on the acknowledgement of the electronic transmission. That notice does not indicate the amount of the offset, however.

The lender collects or may collect information on applicants' (1) name, address, telephone number, and social security number; (2) amount of income, deductions, and refund from the tax return, (3) debts or liens owed to the government; (4) other debts and assets; (5) previous refund anticipation loans; (6) employment, and (7) credit history.

[4] The Internal Revenue Service's publication 1345 advises that it is in no way involved in or responsible for refund anticipation loans. The service states that the government is not liable for any losses suffered by taxpayers, tax preparers, or lenders resulting from refunds that are less than claimed.

Most applications for a refund anticipation loan are accepted. Some lenders advertise that they accept nearly 90 percent of applications. Many refund anticipation loans are for the full amount of the refund less the amount of fees deducted. However, in some situations, lenders may limit loan amounts to control risk. As mentioned, lenders may limit the dollar amount of a refund anticipation loan or the percentage of the refund financed if the customer had no previous refund anticipation loan or a refund anticipation loan from another lender. Lenders may also limit the amount or percentage of the refund anticipation loan covered by an earned income tax credit or limit loans that rely on income from schedule C (sole proprietorships). And lenders may limit or refuse applications if the consumer owes delinquent child support or government debts or liens.

1-3. Costs

This study is concerned with a consumer's decision to obtain a refund anticipation loan. The study makes no attempt to analyze lenders' costs or the profitability of the product. Nevertheless, because of the relatively high annual percentage rates charged for refund anticipation loans, some discussion of the relationship between cost, loan size, and term to maturity in consumer lending is necessary to understand the product.

All lenders perform the same basic activities in providing consumer credit. They take borrower applications, evaluate the applications, prepare documents and disburse funds, process payments, and attempt to collect delinquent accounts. Lenders also incur expenses for marketing, pay taxes on profits, and must provide a return on invested capital.

Previous studies of the cost of consumer lending classify costs into one of several categories: operating costs, taxes, and return on invested capital. Operating costs are the largest category. Operating costs include the salaries and office expenses for loan acquisition and delivery of proceeds, processing and collection of payments, and expenses for bad debts. By far the greatest part of operating costs is expenses for loan acquisition, processing of payments, and collection of past due accounts. Loan acquisition costs include the cost of taking an application, evaluating the application, preparing the loan document, and disbursing the funds. Processing costs include receiving and recording loan payments, monitoring accounts to ensure prompt payment, and contacting customers who are past due to arrange for collection of late payments. Most cost generating activities occur because an application is taken or a loan is made. They do not vary much by size of the loan. In other words, a substantial part of the cost of lending is fixed. Because of the relatively large fixed costs, breakeven annual percentage rates for consumer lending are inversely related to the size and term to maturity of the loan. Empirical analyses for the National Commission on Consumer Finance (1972) indicate that the breakeven annual percentage rate on a larger loan is less than the breakeven annual percentage rate on a smaller loan. An intuitive explanation for this finding is that the fixed cost is spread over a greater loan size. Likewise, analyses indicate the breakeven annual percentage rate for a longer term to maturity is less than that for a shorter term to maturity. An intuitive explanation for this second finding is that the fixed cost of acquisition is spread over time with a greater number of payments.

The empirical results are based on data from different types of creditors many years ago. However, the activities that creditors must perform are largely the same now as they were then, and all types of creditors must perform them. Although information processing systems automate many of these activities, the labor inputs are still substantial. Application information must be entered into the computer. The computer may prepare the loan document, but employees must explain the document to the customer and disburse the funds. Employees must receive payments and record them into the accounting system. They must extract information identifying past due accounts, contact customers, and arrange for collection of late payments. All of these activities entail relatively large fixed costs.

For very small loans, one study for the National Commission on Consumer Finance indicates that breakeven rates are quite high. This study examined costs of the "small" small loan industry in Texas between 1960 and 1970 (Durkin 1975). These small loan companies were licensed to make instalment loans of $100 or less (about $520 or less in 2004 dollars), which had terms to maturity of one to six months.[5] Assuming a term to maturity of 5 months, the minimum annual percentage rate to recover operating costs for an average loan ($53, or $275 in 2004 dollars) was about 194%.[6] Adding taxes, and interest paid on borrowed capital, the minimum breakeven annual percentage rate was about 217%. The return to equity investors would be additional.

The findings of the various studies for the National Commission on Consumer Finance cannot be used to infer breakeven annual percentage rates for refund anticipation loans. The data are old, and the characteristics of the loan products were different from the characteristics of refund anticipation loans. Nevertheless, the analyses in these studies suggest that breakeven annual percentage rates for refund anticipation loans would be relatively high because these loans have a very short term to maturity and are sometimes small in size.

1-4. Regulation

Refund anticipation loans are governed by federal regulations and sometimes state and local regulations.

Federal Regulation

Refund anticipation loans are subject to federal consumer protection laws and regulations for credit to consumers. These laws include the Truth in Lending, Equal Credit Opportunity, Federal Trade Commission Act, Fair Credit Reporting, Fair Debt Collection Practices, and Gramm Leach Bliley acts. Internal Revenue Service regulations have provisions governing refund anticipation loans and the activities of tax preparers and electronic refund originators.

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[5] Texas Consumer Credit Code, Chapter III, Article 3.16 allowed lenders offering "small" small loans charge fees ranging from $1 per $5 of cash advance up to $30 for one month (240 percent annual percentage rate) to 10 percent of the advance plus $4 per months for a 6-month loan of $100 payable in six instalments (108.75% annual percentage rate).

[6] The break-even annual percentage rate is based on the industry expense data reported in table 30 and an average term to maturity estimated from data in table 23 in Durkin (1975).

Particularly pertinent for consumer decisions is the Truth in Lending Act (15 U.S.C. §1692 *et seq.*), which is implemented by the Federal Reserve Board's Regulation Z (12 CFR 226). Truth in Lending is intended to "assure a meaningful disclosure of credit terms so that the consumer will be able to compare more readily the various credit terms available" and to avoid "uninformed use of credit" (15 U.S.C. § 1601(a)). Truth in Lending requires a separate disclosure of the price and other terms of the credit transaction. The key price terms are the annual percentage rate and finance charge. As discussed earlier, the annual percentage rate is the periodic interest rate applied to outstanding balances multiplied by the number of periods in a year. The finance charge is the total dollar amount of all interest payments. Other disclosures are the amount financed, total of payments, payment schedule, and notice of security interest, a demand clause, a late charge, and a prepayment penalty, if applicable. Exhibit 1 in the appendix to this chapter shows the Truth in Lending disclosure in a loan contract for a refund anticipation loan.

The loan term for any refund anticipation loan is not known in advance because it depends on the time the Internal Revenue Service takes to process the tax return. The Federal Reserve Board's Commentary to Regulation Z (12 CFR 226.36, Supplement I) states that the Truth in Lending disclosures should be based on the creditor's estimate of the time the refund will be delivered if the loan requires repayment when the refund is received.[7]

The Commentary also provides guidance on determining the finance charge. The finance charge includes any amounts repaid over the amount financed that are charged in connection with the refund anticipation loan and would not be charged in an otherwise comparable cash transaction. In addition, if the amount of a fee charged for a refund anticipation loan exceeds the fee charged for a cash transaction, the difference would be included in the finance charge.

The Internal Revenue Service regulates refund anticipation loans through its rules governing providers of electronic tax filing.[8] These rules cover the tax preparation services that offer to arrange refund anticipation loans since these firms are also normally electronic filing providers.

The Internal Revenue Service rules cover disclosure, advertising, fees charged for arranging refund anticipation loans, and several other aspects of an electronic filing provider's relationship with the consumer. The disclosure rules require the electronic

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[7] Annual percentage disclosures using a one-year term to maturity for refund anticipation loans with a demand feature were cited in a 1992 action by the New York City Commissioner Mark Green against Beneficial National Bank (Yvette D. Kantrow, "Court Directs a N.Y. Bank to Stop Lending Linked to Tax Refunds," *American Banker*, March 27, 1992, p. 13). Generally, Regulation Z allows use of a one-year term to maturity on demand loans.

[8] See Internal Revenue Service Publication 1345 for rules governing refund anticipation loans. The Internal Revenue Service registers electronic filing providers (see Publication 3112). The registration process includes a criminal background check and other reviews of firms applying to become electronic filing providers.

filing provider to disclose that a refund anticipation loan is a loan, that the loan is neither an substitute for a refund nor a faster way to receive a refund, and that the borrower may owe additional interest on the loan if the refund is not received in the expected time.

The advertising rules require that advertisements state clearly that a refund anticipation loans is a loan advanced against an anticipated refund, not the refund itself. The advertising rules also generally prohibit deceptive or misleading advertising. To facilitate monitoring and enforcement, the rules require that electronic filing providers retain copies of all advertising.

The rules governing fees stipulate that an electronic filing provider may charge the borrower a fee for help in arranging a refund anticipation loan. The rules specify that the fee must be a flat fee that is identical for all customers. The fee may not vary depending on the size of the loan or the amount of the refund. The electronic filing provider may also receive a fee from the lender. This fee also may not depend on the size of the refund anticipation loan or the amount of the refund.

Other Internal Revenue Service rules governing refund anticipation loans prohibit an electronic return provider from making the loan, require the electronic return provider to obtain the borrower's written consent to provide tax information to the lender, and prohibit the electronic return provider from cashing a customer's refund check.

State and Local Regulation
Refund anticipation loans are subject to applicable state laws governing consumer lending, including state rate ceilings. In practice, however, refund anticipation loans are granted by banks located in states with high or no rate ceilings. These banks operate under a provision of the National Bank Act (12 U.S.C. §§ 85-86) that allows federally chartered banks to charge any rate allowed in the state in which the bank is located, regardless of the location of the borrower.[9] Local tax preparation services act as middlemen for refund anticipation lenders. The key requirements for such arrangement are that the bank grants the loan and the local tax preparation service is not owned by the bank. The courts have consistently upheld this provision.[10]

Several states, two counties, New York City, and Seattle require specific additional disclosures for refund anticipation loans. The disclosure requirements for Wisconsin, Connecticut, Illinois, and North Carolina are similar. First, these states require disclosure of options for electronic filing of tax returns and for processing of refunds. This disclosure includes any fees associated with these options. Second, they require disclosure of the amount financed, finance charge, assumed loan term and annual percentage rate for several different loan amounts. Third, a transaction specific

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[9] *Marquette v. First of Omaha Serv. Corp.,* 439 U.S. 299 [1978]; *Smiley v. Citibank (South Dakota), N.A.*, 135 L. Ed. 2d 25, 116 S. Ct. 1730 [1996].The Depository Institutions and Deregulation and Monetary Control Act of 1980 (12 U.S.C. § 1831d(a), §1463(g), § 1785(g), and § 1735f-7a) extended this provision to state-chartered banks and other financial institutions accepting federally insured deposits.
[10] *Cade v. H&R Block, Inc.*, 43 F. 3d 869 (4th Cir., 1994); *Christiansen v. Beneficial Nat'l* Bank, 972 F. Supp. 146 (S.D. Ga., 1997); *Basile v. H&R Block, Inc.*, 897 F. Supp. (E.D. Pa. 1995).

disclosure of refund anticipation loan cost terms is required. Finally, these states require a notice of other fees that are deducted from the amount financed.

Minnesota and New York City have more limited disclosure requirements than Wisconsin, Illinois, and North Carolina. Minnesota and New York City require disclosure of the annual percentage rate, fees, and the estimated time to receive a refund for an electronic filing if a refund anticipation loan is not obtained. New York City also requires a statement that the borrower is obligated to pay the entire amount of the loan and fees, regardless of the amount actually refunded.

An example of state disclosures is shown in exhibit 2 of the appendix to this chapter.

1-5. Policy Issues

Several controversies are associated with refund anticipation loans. They are (1) the high cost of refund anticipation loans, particularly when expressed as annual percentage rates; (2) a diversion of refunds in part based on the earned income tax credit to tax preparation services and lenders because of earned income tax credit recipients' use of refund anticipation loans; (3) customers' awareness that refund anticipation loans are loans, not one of several options for receiving a tax refund; and (4) the question of what fees should be included in the finance charge.

High Cost of Refund Anticipation Loans

Consumerist organizations (Hermanson and Gaberlavage 2001; Wu, Fox, and Renuart 2002; Wu and Fox 2004; Wu and Fox 2005) and some researchers are critical of the high level of annual percentage rates charged for refund anticipation loans (Berube *et al*. 2002; Quinn 2002; Barr 2004). They frequently describe these loans as usurious. Critics often recommend limits on refund anticipation loan fees. Some recommend banning the product outright, arguing that consumers would be better off without the credit.

Suppliers argue that some consumers may benefit from refund anticipation loans.[11] The benefits include faster receipt of funds through loans than other options for filing and receiving funds and less risk of lost or stolen refund checks for refunds sent through the mail. Suppliers also argue that tax preparers may be able to obtain greater tax deductions or credits than some consumers would claim if they prepared taxes themselves and that the ability to deduct tax preparation fees from the proceeds of a refund anticipation loan may facilitate cash constrained consumers' use of tax preparation services.

Economic research provides some guidance on the consequences of fee limits. As discussed in section 1-3, breakeven annual percentage rates for refund anticipation loans are likely quite high because of the small loan size or a very short term to maturity. Lenders would therefore need to charge high annual percentage rates for refund anticipation loans if such credit is to be made available in the market.

Many economists recommend policies that promote competition in the market, which according to economic theory provides consumers with goods and services at the lowest

[11] See, for example, Decision Strategies International *et al*. (1997).

cost. The policies come in two forms. First, traditional economic theory suggests policies that avoid restricting entry or otherwise impeding competition, which tend to raise prices in the market. Second, economic theory regarding information suggests policies that promote the provision of information that allows consumers to make informed choices among alternatives in the market.[12]

Non-market policies consist of subsidized or charitable lending and interest rate ceilings. A review of the history of consumer lending in the United States suggests that privately subsidized or charitable lending would not be sufficient to satisfy demand for such credit (Michelman 1966; Calder 1999). Publicly subsidized short-term consumer lending is unlikely.

Interest rate ceilings have historically been a major component of public policy in consumer credit markets. Evidence indicates that binding interest rate ceilings restrict availability of credit, limit competition and raise prices, and cause resources to be wasted in efforts to evade the ceilings (National Commission on Consumer Finances 1972; Durkin 1993; Staten and Johnson 1995).[13] Since most refund anticipation loans are made by national banks, imposition of interest rate ceilings at the state level would have little effect in the absence of federal restrictions.

To assess whether or not consumers would be better off without refund anticipation credit, empirical evidence on consumers' behavior is required. Little empirical evidence is currently available.

Diversion of Earned Income Tax Credits

The high cost of refund anticipation loans is often mentioned in connection with the earned income tax credit. The earned income tax credit is a refundable tax credit for individuals who work but do not earn high incomes. Income thresholds are higher for individuals who have children than those who do not.

Critics of refund anticipation loans have argued that earned income tax credit recipients cannot afford refund anticipation loans because of their high cost. Critics have also questioned the policy of providing subsidies to lower income consumers through a tax system that is widely regarded as complex. This policy, critics argue, drives consumers to tax preparation services, diverting a share of tax subsidies from intended recipients to tax preparation services and lenders.

A discussion of alternative systems for delivering subsidies is beyond the scope of this study. Earned income tax credit recipients' limited incomes suggest that these consumers may have experience restrictions in credit availability and turn to high-cost credit. The

[12] See Durkin and Elliehausen (2004) for discussion of traditional economic theory and the economics of information.

[13] Wallace (1976) and Avio (1973) supported a policy of interest rate ceilings precisely because ceilings restrict credit availability, arguing that some consumers would be better off without having access to credit. Perhaps the attractiveness of interest rate ceilings is that limiting prices charged by lenders is popular, but limiting consumers' access to credit is not.

question whether these customers would be better off without access to refund anticipation loans again is best addressed with empirical evidence on consumers' behavior.

Understanding of Refund Anticipation Loans

Consumerist groups have claimed that refund anticipation customers are misled to believe that refund anticipation loans are refunds from the government, not loans (Wu, Fox, and Renuart 2002; Wu and Fox 2003; Wu and Fox 2004; Wu and Fox 2005). Tax preparation services and lenders have been alleged in several lawsuits to have provided misleading information about refund anticipation loans.

Evidence that misunderstanding is widespread is lacking. Lewis, Swagler, and Burton (1996) attempted to address the question of misunderstanding in a survey of 49 consumers, who were identified by asking a screening question outside two branches of national discount stores. The screening question asked whether the consumer had obtained a "quick refund." The 49 consumers who responded affirmatively were asked whether their "quick refund" involved a loan. It is not clear that these questions would elicit the desired information. "Quick refund" is not the trade name for any refund anticipation loan product, and no description of the product was provided in the question. It is quite possible that consumers would not recognize that they were being asked about refund anticipation loans.

In December 2004, the National Consumer Law Center commissioned a polling firm to survey consumers about refund anticipation loans (Wu and Fox 2005). The questionnaire adopted the Lewis, Swagler, and Burton approach, asking whether respondents had ever obtained a "rapid or speedy refund," which was described as a service that allows the taxpayer to get his refund in one to three days. Respondents who answered affirmatively were then asked whether the "rapid or speedy refund" involved a loan. Wu and Fox (2005) report that 70 percent of respondents receiving a refund anticipation loan (presumedly answering "yes" to the question on receipt of a "rapid or speedy refund") did not realize that they had received a refund anticipation loan (answered "no" to the question whether the refund involved a loan).

Again, it is not clear that respondents would have recognized that they were being asked about refund anticipation loans. "Rapid refund" and "speedy refund" are not trade names for any refund anticipation loan product.[14] Use of the term "refund" to describe the product is misleading, despite the reference to a "one to three days" time period for receiving the refund. As mentioned earlier, Internal Revenue Service rules require electronic filing providers to disclose that a refund anticipation loan is a loan and that the loan is neither an substitute for a refund nor a faster way to receive a refund. Receipt of a refund in one to three days is not possible. Knowledgeable respondents who obtained some form of expedited processing (through electronic filing or direct deposit, for example) may have responded negatively to the first question because they did not obtain a refund in one to three days. Knowledgeable respondents who obtained a refund anticipation loan may have responded negatively because they received a loan, not a

[14] In the past, H&R Block used the term "rapid refund" for their electronic filing product.

refund, in one to three days. Respondents answering the first question affirmatively likely include both consumers who received some form of expedited processing and consumers who obtained a refund anticipation loan but did not pay close attention to the question.

Some consumers may have been unaware or uncertain whether that the product was a loan when refund anticipation loans were first introduced.[15] Since that time, tax preparation services and lenders have changed advertising, disclosures, and loan documents for refund anticipation loans in response to market conditions, regulatory scrutiny, and litigation. That many consumers currently believe that refund anticipation loans are not loans is doubtful. Tax preparation firms and lenders explicitly call the product a refund anticipation loan. They also avoid language suggesting that the loan is the refund. The term refund anticipation loan is included in advertising, informational brochures, and all loan documents.[16]

Disclosure and advertising that the product is a loan is mandated by government regulations and enforced by regulatory agencies and by private litigation. The regulations include Internal Revenue Service rules, Truth in Lending disclosures, and additional disclosures in some states or municipalities. Refund anticipation loans are generally from banks, which are regularly examined for compliance with government regulations.

Tax preparation services and lenders have been sued in the courts for alleged violations disclosure and advertising requirements. The courts have found that tax preparation services and lenders satisfy Truth in Lending disclosure requirements, which identify the product as a loan and provide information on cost and other credit terms. The courts generally have not found evidence of systematic misrepresentation or fraud against these companies.[17] A notable exception involved a tax preparation service's substitution of the term "refund anticipation advance" for refund anticipation loan in a few markets in which the firm was testing a zero fee refund anticipation loan.[18] The firm was sued by a competitor, which claimed that the firm's advertising was misleading and deceptive and that it had lost customers because of the advertising. The court concluded that the advertising was indeed misleading and deceptive and ordered the tax preparation service to comply with the Internal Revenue Service advertising rules for refund anticipation

[15] Beneficial used the trade name "Instant Tax Refund Plan" and referred to the product as a cash advance in advertising when it introduced a refund anticipation loan in 1969. Within a year, Beneficial changed its advertising to refer to the product as a loan rather than cash advance and added a statement the customer would have to qualify for the loan. Despite the qualifying language explaining that the product is a loan, the Federal Trade Commission prohibited Beneficial from using the trade name, arguing that the trade name was in itself misleading. In an appeal for a review of the prohibition, the court rejected the commission's argument that the trade name was intrinsically misleading. Beneficial Corp. v. FTC, 542 F. 2d 611 (3rd Cir 1976).

[16] Examples of an information brochure, a refund anticipation loan information sheet, and an advertisement for refund anticipation loans are shown in exhibits 3, 4, and 5 of the appendix to this chapter.

[17] See Zawikowski *et al*., No. 98 C 2178, No. 98 C 2550 (N.D. Il. 2000).

[18] JTH Tax Service v. H&R Block, 128 F. Supp. 2d 926 (E.D. Va. 2001).

loans. The court also ordered the tax preparation firm to pay compensatory damages to the complainant.

In sum, current practice clearly identifies refund anticipation loans as loans. This practice is mandated by government regulation. It is enforced by regulatory examinations, regulatory scrutiny, and litigation. That consumers generally understand that refund anticipation loans are loans, not actual tax refunds, is highly likely.

Definition of Finance Charge

Consumerist organizations also criticize the current disclosure rules, contending that they understate the cost of refund anticipation loans.[19] They often suggest that the cost of refund anticipation loans should include fees for services such as electronic filing, tax preparation, and temporary deposit accounts to receive the refunds electronically, repay the loan, and distribute any excess to the borrower.[20]

The critics' approach is contrary to the approach taken by Truth in Lending and Regulation Z, which holds that the any charge that is "imposed … as an incident to or a condition of" the credit is a finance charge and that "any charge of a type payable in a comparable cash transaction" is not a finance charge (Reg. Z §226.4(a)). Electronic filing and temporary accounts may be used to obtain a more timely refund when a refund anticipation loan is not taken out. These services do not involve an advance of funds and are not finance charges according to Regulation Z. The refund anticipation loan fee (and the annual percentage rate under Regulation Z) is for the advance that speeds receipt of funds from ten to one or two days.

Whether electronic filing and temporary account fees should be included may be arguable, since these features influence the term to maturity of the loan. The argument is part of a larger issue of what constitutes a finance charge in a credit transaction, however. It is not an issue peculiar to the refund anticipation loan product.[21] But the use of the minimum 10-day term to maturity for calculation of annual percentage rates is inconsistent with the inclusion of these fees in the finance charge. Because electronic filing and direct deposit of returns reduce the time to obtain a refund from as long as 45 days for paper filing and receipt of a refund in the mail, inclusion of these fees would call for the assumption of the longer term to maturity in calculating the annual percentage rate.

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[19] For example, Wu and Fox (2004) contend: "Tax preparation chains and RAL [refund anticipation loan] lenders have been reporting lower Annual Percentage Rates (APRs) by 'unbundling' charges from the loan fees. These APRs give a less accurate picture of the true 'cost of credit' for RALs." (p. 2)

[20] In a section titled "The Price of RALs," for example, Wu, Fox, and Renuart (2002) state: "Consumers pay three fees to get a refund anticipation loan: a fee to a commercial tax preparer for filling out the federal and state tax forms, … a fee for the electronic filing, … and a loan fee to the lender …" (p. 5)

[21] Other proposed approaches for defining the finance include treating as finance charges (1) all fees the consumer agrees to pay, whether or not they are incurred solely in the credit transaction, and (2) any payments made to the creditor, whether or not they are made by the borrower. For discussion of issues in defining the finance charge, see Rohner and Durkin (2005).

In contrast, treating tax preparation fees as part of the cost of a refund anticipation loan has no justification. Credit has four basic features: credit origination, funding or forbearance, servicing, or risk taking (Rohner and Durkin 2005). Tax preparation is an entirely different product. It does not have any of the four features of credit. Tax preparation involves no advance of funds. Hence, there is no origination, funding, servicing, or risk-taking. Furthermore, tax preparation does not affect the time between filing and return and receipt of a refund. Thus, even under a broader definition of finance charge that might include electronic filing and temporary account fees, tax preparation would not be a finance charge.

1-6. Purpose of this Study

There are many unanswered questions about refund anticipation loans. They include questions of who uses refund anticipation loans, why consumers use refund anticipation loans, and what do they understand about these loans. The purpose of this study is to use tools from economic and psychological analyses of consumers' credit behavior to interpret survey data on refund anticipation loan use.

APPENDIX TO CHAPTER 1

Exhibit 1: Truth in Lending Disclosure and Loan Agreement

FD - RALV - DD RAL Voucher - 1 office copy

H SAFEE EQL THRTYTW

OFFICE Copy Signature Required

486-88-0505

LOAN AGREEMENT AND DISCLOSURE STATEMENT

In this Loan Agreement and Disclosure Statement ("Agreement"), "RAL" means a Refund Anticipation Loan, "ICB" means Imperial Capital Bank, "I", "me" and "my" means each person who has applied to ICB for a RAL. "H&R Block" means each of H&R Block, Inc., and each of its affiliates and subsidiaries (and franchisees thereof). "HTMI" means Household Tax Masters Inc.

The following Truth in Lending Act ("TILA") disclosures are based on a RAL in the amount specified in item 10 of the Itemization of Amount Financed. I will receive a replacement TILA Disclosure Statement if I am approved for a RAL in a smaller amount. In addition, I may receive a duplicate copy of this TILA Disclosure Statement if I am approved for a RAL in the amount on which this disclosure is based, and the RAL is disbursed to me by check.

Truth in Lending Act Disclosure Statement

1. Amount Financed (the amount of credit provided to me or on my behalf)	$	2,955.00 (e)
2. **FINANCE CHARGE** (the dollar amount the credit will cost me)	$	75.00 (e)
3. Total of Payments (the amount I will have paid after I have made all payments as scheduled)	$	3,030.00 (e)
4. **ANNUAL PERCENTAGE RATE** (the cost of my credit as a yearly rate)		84.217% (e)

"e" = estimate — If line is left blank, amount is "0"

Creditor: My creditor is Imperial Capital Bank.
Demand Feature: My loan will be repayable on demand or when the anticipated tax refund is electronically deposited in my Refund Account, whichever is earlier.
Payment Schedule: ICB estimates that the total loan amount will be due in a single payment approximately 12 days from the date of this Agreement.
Security Interest: I am providing ICB with a security interest in my tax refund payment by the IRS, in the Refund Account where it is deposited, and in all funds deposited in that Refund Account.
Late Charge: A late charge equal to 1.5% of the unpaid Total of Payments may be imposed on the date 35 days after payment of my loan is demanded, and on the same date of each succeeding month (or if there is no such date, the last date of the month).
Prepayment: If I pay off early, I will not be entitled to a refund of part or all of the Finance Charge.
Contract Reference: Refer to the Application and the accompanying Loan Agreement for additional information about nonpayment, default, any right to accelerate the maturity of the obligation, and any prepayment rebates or penalties.
Required Deposit: The Annual Percentage Rate does not take into account my required deposit.

Itemization of Amount Financed		
1. Amount paid directly to me	$	2,788.05 (e)
2. Amount paid for my Refund Account Fee to ICB	$	24.95
3. Amount paid for Tax Prep to H&R Block	$	110.00
4. Amount paid for debt owed to H&R Block	$	0.00
5. Amount paid for System Administration Fee to H&R Block	$	32.00
6. Amount paid for Peace of Mind to H&R Block	$	0.00
7. Amount paid for E-Filing to H&R Block	$	0.00
8. Amount Financed (Items 1+2+3+4+5+6+7)	$	2,955.00 (e)
9. Prepaid **FINANCE CHARGE** (RAL Fee to ICB)	$	75.00 (e)
10. Total RAL (Items 8+9)	$	3,030.00 (e)

"e" = estimate — If line is left blank, amount is "0"

Loan Agreement

1. Obligation on RAL. (a) I am obligated, on the date I sign this Agreement, to accept a RAL if ICB approves my Application, unless ICB approves me for a smaller RAL than the amount set forth in the Total of Payments section in the TILA Disclosure Statement above. If I am approved for a smaller RAL, I will be provided with a replacement TILA Disclosure Statement and I will be obligated to accept the smaller RAL if I accept the RAL proceeds check. My loan will begin, and ICB will earn the finance charge, when I am approved for the RAL and the proceeds check is made available or a transfer is initiated to my bank account. (b) I may cancel my RAL transaction, or my obligation to accept a RAL, for up to 48 hours after I become obligated to accept the RAL. To do so, I must return to ICB or the office where I received my RAL proceeds check or any check I have received (or cash in the amount of the RAL proceeds check if I have cashed the check or received a transfer to my bank account), and comply with other requirements set by ICB. I understand that, if I use my right to cancel, my finance charge will be refunded to me, ICB will provide me with any tax refund only after ICB receives the refund from the IRS, and I must still pay a Refund Account Fee.
2. Security Interest. If I receive a RAL, I grant ICB a security interest in the property described in the TILA Disclosure Statement as collateral for my obligations to repay the RAL and perform my other obligations under the Terms of Application and this Agreement.
3. Deductions. My Prepaid Finance Charge, Refund Account Fee, fees for the completion and system administration of my income tax return by H&R Block, and amount owed to H&R Block from prior years shall be deducted from the proceeds of my RAL.
4. Other Charges. I agree to pay a returned check charge of $19 if any check or similar instrument I give ICB is not honored, and I agree to pay a late charge as described in the TILA Disclosure Statement if I do not repay my loan when due. I also agree to pay any attorney's fees and collection agency costs incurred by ICB or its affiliates to collect any delinquent RAL as permitted by law.
5. Instant RAL. If I receive an Instant RAL, and if the electronic filing of my return is rejected by the Internal Revenue Service ("IRS"), I authorize my ERO to insert my Refund Account number at ICB, together with ICB's routing transit number, on my signed paper returns, and mail them to the IRS.
6. Application of Payments. Each payment I make on the RAL will be applied in any order determined by ICB.

BY SIGNING BELOW, I AGREE TO THE TERMS OF THIS LOAN AGREEMENT, AND TO THE APPLICATION, WHICH INCLUDES AN ARBITRATION CLAUSE WHICH MAY SUBSTANTIALLY LIMIT MY RIGHTS IN THE EVENT OF A DISPUTE. I ALSO ACKNOWLEDGE RECEIVING A COMPLETED COPY OF THIS LOAN AGREEMENT AND DISCLOSURE STATEMENT.

CAUTION: IT IS IMPORTANT THAT YOU THOROUGHLY READ THIS CONTRACT BEFORE YOU SIGN IT.
NOTICE TO CUSTOMER
(a) DO NOT SIGN THIS IF IT CONTAINS ANY BLANK SPACES.
(b) YOU ARE ENTITLED TO AN EXACT COPY OF ANY AGREEMENT YOU SIGN.
(c) YOU HAVE THE RIGHT AT ANY TIME TO PAY IN ADVANCE THE UNPAID BALANCE DUE UNDER THIS AGREEMENT AND YOU MAY BE ENTITLED TO A PARTIAL REFUND OF THE FINANCE CHARGE.

Date: ____________ ______________________ (seal) ______________________ (seal)

Signature of Applicant — Signature of Joint Applicant

Exhibit 2: State Refund Anticipation Loan Disclosure

COMPLETE THIS FORM FIRST! **SEPARATE DISCLOSURE FOR WISCONSIN, OREGON, ILLINOIS, AND NORTH CAROLINA**

A Refund Anticipation Loan, or RAL, is a short term loan offered by Santa Barbara Bank & Trust ("SBBT") through Jackson Hewitt, Inc. ("JHI") and your Jackson Hewitt Tax Service(R) TaxPreparer/Electronic Filer ("Tax Preparer"). SBBT is a division of Pacific Capital Bank, N.A. Please read the following disclosure that discusses important information concerning the cost of a RAL and how you can obtain your refund without applying for a RAL.

IMPORTANT DISCLOSURE

1. **You can file your tax return electronically and obtain your refund directly from the IRS without obtaining a RAL from SBBT.** If you file your tax return electronically, you can receive a refund check directly from the IRS within 21 to 28 days from the time you file your tax return or the IRS may deposit your refund directly into your bank account in as little as 9 to 16 days from the time you file your tax return.
2. **You can file your tax return electronically and have SBBT process your income tax refund without obtaining a RAL from SBBT.** If you file your tax return electronically, you can request the IRS to deposit your refund with SBBT. Upon receipt of your refund, SBBT will deduct and pay from your refund any fees charged for the preparation and filing of your electronic tax return and any other amounts authorized by you and disburse the balance of your refund to you in as little as 9 to 16 days from the time you file your tax return. SBBT will deduct $25 from your refund for this service (SBBT charges an additional $10 to process your state refund).
3. **You can file your tax return electronically and apply for a RAL from SBBT.** If you file your tax return electronically and apply for and are approved for a RAL, the loan proceeds will be available to you in as little as 1 to 2 business days from the time you file your tax return. A RAL is a loan from SBBT in the amount of all or part of your refund. Your refund is used to pay back the loan. If you apply and are approved for an advance on your RAL, up to $700 of your RAL proceeds will be available to you within 1 hour from the time you file your tax return. You do not have to apply for a RAL Advance in order to apply for a RAL. The average repayment term for a RAL is 10 days. SBBT's Finance Charge for a RAL is equal to 3.0% of the RAL, but not less than $10 or more than $75. The Finance Charge will be increased by $10 if the tax refund includes Earned Income Tax Credit (EIC) and/or will be increased by $30 if you received an advance on your RAL. See the following chart for a representative range of costs of RALs.
4. **You are responsible for repaying the RAL and RAL fees in the event the IRS does not pay your refund in whole or in part.**

Representative Range of Loan Amounts and Costs (Includes $10 EIC charge)*

Total Loan Amount	Amount Financed	FINANCE CHARGE	Estimated Payment Period	ANNUAL PERCENTAGE RATE
$ 500	$475.00	$25.00	10 days	192.11%
$ 750	$717.00	$33.00	10 days	167.99%
$1000	$960.00	$40.00	10 days	152.08%
$1500	$1445.00	$55.00	10 days	138.93%
$2000	$1930.00	$70.00	10 days	132.38%
$3000	$2915.00	$85.00	10 days	106.43%

*If you apply for and are approved for a RAL and a RAL Advance, both the Finance Charge and the APR shown above would increase (see the itemization below). There are other fees associated with the preparation and filing of your tax return and the processing of your refund that are deducted from the RAL. These fees include SBBT's federal refund processing fee of $25 and the documentation and tax preparation fees charged by the Tax Preparer.

ADDITIONAL DISCLOSURES

Your cost for a RAL in the amount of ______________ would be as follows:

1. Finance Charge $ ______________
2. Electronic Filing Fee $ ______________
3. Total Cost $ ______________
4. Estimated Annual Percentage Rate ("APR") of the RAL ______________%

Please Note: In addition to the Total Cost shown on Line 3 above, there are other fees associated with the preparation and filing of your tax return and the processing of your refund that are deducted from the RAL. These fees include SBBT's federal refund processing fee of $25 and the documentation and tax preparation fees charged by the Tax Preparer. Please refer to the Truth-In-Lending Disclosure in your SBBT Refund Processing and Refund Anticipation Loan (RAL) Application and Agreement for the actual Finance Charge, Annual Percentage Rate and other fees assessed on your RAL transaction.

Wisconsin Residents: Wisconsin law provides that no agreement, court order, or individual statement applying to marital property will affect a creditor's interest unless, prior to the time credit is granted, the creditor is furnished with a copy of the agreement, court order or statement, or has actual knowledge of the adverse provisions.

BY SIGNING BELOW, YOU ACKNOWLEDGE RECEIVING A COPY OF THIS IMPORTANT INFORMATION BEFORE YOU SIGNED THE APPLICATION FOR A REFUND ANTICIPATION LOAN.

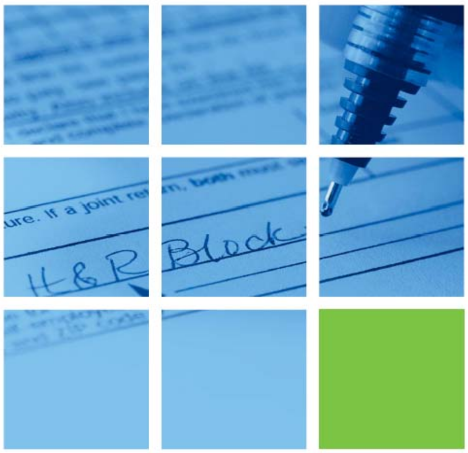
Signature of Primary Taxpayer ______ Date ______ Signature of Secondary Taxpayer ______ Date ______

F 12/11/03

Exhibit 3: Information Brochure

tax and financial services

welcome to H&R Block



tax-smart advice to get you every advantage today and tomorrow

H&R BLOCK®

For your refund or balance due choose what's right for you

At H&R Block, we have several options to help you get money quickly. If you have taxes due instead, we offer convenient ways to pay your balance. Your tax professional will describe the fees and timing associated with these options.

Refund options

IRS direct deposit or check. We will electronically file your return. The IRS generally will deposit your refund into your bank account within 10-14 days if you select direct deposit, or mail you a refund check within 3 weeks.

Mail-in option. You can mail your return to the IRS and receive your refund within 5-7 weeks through a direct deposit or 6-8 weeks with a check mailed to you.

Refund Anticipation Check (RAC). Pick up a check or have money directly deposited within 8-15 days after electronic filing for the amount of your refund minus bank fees and H&R Block's fees.[1] (Clients must qualify.)

Refund anticipation loan (RAL) options[2]

Classic RAL. In as little as 1-2 days, you can pick up a check for a loan for the amount of your refund minus bank fees and H&R Block's fees.[1] (Clients must qualify for this bank product.)

Instant Money RAL. Get money on the spot. That's right. Walk in with your taxes—walk out with a check for a loan in the amount of your refund minus bank fees and H&R Block's fees.[1] (Clients must qualify and pay a fee that is higher than the Classic RAL fee.)

Balance due options

Easy Pay Loan. Take 90 days after April 15 to pay your IRS balance due and H&R Block's fees. If you qualify, you can apply for an Easy Pay line of credit from Imperial Capital Bank ("ICB") for up to $8,000[3]. When your federal taxes are due, ICB will transfer your federal balance due from your ICB credit account to the IRS and will also pay your tax preparation fees from that account.

Electronic Bank Draft. With your consent, your tax professional can arrange for the Treasury Department to deduct payment from your bank account.

Check or Money Order. Make a check or money order payable to the United States Treasury, and mail it to the address provided by your tax professional.

1. Tax preparer and bank fees are withheld from your total check so you don't pay any money today.
2. An additional fee, disclosed as an interest rate, is charged by Imperial Capital Bank, the lender. Instant Money has limited availability based on creditworthiness. Those not qualifying for Instant Money may qualify for a Classic RAL.
3. No finance charges will apply if the line of credit is paid in full within 90 days after the April 15 due date. However, there is an annual account fee of $19.95 that applies even if the balance due is paid within 90 days. If the loan is not paid within 90 days, variable interest is charged on the federal taxes and the Block fees paid by ICB at an Annual Percentage Rate ("APR") of 14.9% plus the Prime Rate. As of September 30, 2003, the APR is 18.9%

4

Exhibit 4: Refund Anticipation Loan Information Sheet

facts about Refund Anticipation Loans

What is a RAL?

- A Refund Anticipation Loan (RAL) is a bank loan based on the amount of your anticipated IRS tax refund.
- You must repay the full amount of the loan and related fees, even if the IRS does not send all of your refund.
- Imperial Capital Bank (the bank) is the lender and Household Tax Masters services RALs available at H&R Block offices.

What Does a RAL Cost?

- Typical RAL fees and interest rates (APRs) are shown on TABLE 1 (next page).
- RAL costs include 3 parts:
  - √ A refund account set-up fee of $24.95, paid to the bank, to set up an account to receive your tax refund and pay off your loan;
  - √ A fee of up to $59 paid to H&R Block for administering and transmitting information to the bank (this fee does not apply at certain locations); and
  - √ Interest on the loan, paid to the bank – this varies by the amount of the loan and how fast you choose to receive it, and is stated as an Annual Percentage Rate (APR). The bank's refund account fee and H&R Block's fee are not part of the APR calculation.
- Interest rates are high on RALs compared to other kinds of credit because the term of the loan is short – RALs are usually repaid within two weeks, although the rates are described in full-year terms.

How Fast Can I Get My Money With or Without A RAL?

- Without a RAL – if you file your return electronically, you can get your IRS refund without additional fees in about 10-14 days with IRS direct deposit to your bank account, or in about 3 weeks by IRS mailed check.
- With a RAL – if you apply and are approved, you will receive your money, minus tax preparation and RAL fees, within 2 days with a Classic RAL, and the same day with an Instant RAL at an H&R Block office.
- The Timeline on TABLE 2 (next page) shows how long it should take to get your money under various options.

What Else Should I Know?

- The amount you receive as a refund loan will be less than your full IRS tax refund because the RAL fees and your tax return preparation fees will be subtracted (see TABLE 3 for an example).
- You must complete a RAL application that will be sent to the bank for processing and approval. If your application is not approved, the bank will still charge you a refund account fee.
- H&R Block may purchase an interest in your RAL. Your tax return preparer may receive payment for electronically filing your return.
- Federal and state laws, and the terms of the agreement on your loan application, apply to RALs. In agreeing to arbitration as a way to resolve disputes, you may be waiving your right to participate in lawsuits.
- You will receive a detailed federal "Truth in Lending Act" disclosure if you apply for a RAL. This brief fact sheet does not replace that disclosure or other information on your application.
- YOU SHOULD READ ALL DISCLOSURES CAREFULLY. If you have questions, ask your tax professional.

H&R BLOCK®

104628 - Standard 12/03

Exhibit 4: Refund Anticipation Loan Information Sheet (continued)

Table 1: Sample Refund Anticipation (RAL) Loan Fees

Loan Amounts	Classic RAL Interest	APR* for Classic RAL Interest	Instant RAL Interest	APR for Instant RAL Interest	Bank Deposit Account Fee**	HRB Fee (Est – Range $0 – $59***)	Total Fees for Classic RAL	Total Fees for Instant RAL
$ 200 – 500	5.00	200 – 85% 500 – 34%	20.00	200 – 338% 500 – 127%	24.95	32.00	61.95	76.95
$ 501 – $ 1000	15.00	501 – 102% 1000 – 51%	30.00	501 – 194% 1000 – 94%	24.95	32.00	71.95	86.95
$ 1001– 1500	35.00	1001 – 120% 1500 – 79%	50.00	1001 – 160% 1500 – 105%	24.95	32.00	91.95	106.05
$ 1501– 2000	45.00	1501 – 103% 2000 – 76%	60.00	1501 – 127% 2000 – 94%	24.95	32.00	101.95	116.95
$ 2001– 7000–	75.00	2001 – 129% 7000 – 36%	90.00	2001 – 143% 7000 – 40%	24.95	32.00	131.95	146.95

*Annual Percentage Interest Rate **These fees are not included in the APR calculation
*** This is an average fee. This fee varies by location, and is not included in the APR calculations

Table 2: Timeline

Filing/Money Options	Receive Money***	Tax Preparation Fee Required Up Front?
Paper Return IRS Mailed Check	6-8 weeks*	Yes
Paper Return IRS Direct Deposit to Your Bank Account	5-7 weeks*	Yes
E-Filed Return IRS Mailed Check	3 weeks*	Yes
E-Filed Return IRS Direct Deposit to Your Bank Account	10-14 days*	Yes
E-Filed Return Refund Anticipation Check	8-15 days**	No
E-Filed Return Refund Anticipation Loan	1-2 days**	No
E-Filed Return Instant Refund Anticipation Loan	Same Day**	No

*IRS does not guarantee a specific date that refunds will be received
**H&R Block and Imperial Capital Bank do not guarantee a specific date for check availability
*** Direct Deposit RAL may take one additional day due to Automated Clearinghouse (ACH) process.

Table 3: IRS Refunds and RAL Amounts

This illustrates a typical Classic refund anticipation loan showing the effect of deducting interest and fees from the RAL amount. As an example, a $2,500 refund would result in a loan amount smaller than the full IRS refund:

Anticipated Refund	$2,500.00
Minus tax preparation fee	- 120.00
Minus Bank interest	- 75.00
Minus Bank refund account fee	- 24.95
Minus H&R Block administrative fee*	- 32.00
Amount received as a Classic RAL	= $2,248.05
Annual Percentage Rate (APR)	103%

*Estimate

H&R BLOCK®

Exhibit 5: Advertisement for Refund Anticipation Loans

Sign in window of tax preparation office

CHAPTER 2
SURVEY OF REFUND ANTICIPATION CUSTOMERS

This study analyzes nationally representative data on tax refund anticipation customers. The data were collected as part of national telephone omnibus survey conducted by International Communications Research, a survey research firm in Media, Pennsylvania.

An omnibus survey is a shared survey, in which sets of questions from different sponsors are combined in a single survey. The costs of establishing contact with a respondent and collecting common demographic information are shared among survey sponsors.

An omnibus survey is often a cost effective way to interview relatively rare populations. Sharing the cost of establishing contact with other survey sponsors reduces the cost of screening a large number of respondents for a characteristic of interest for further questioning. Responses from successive random surveys can be combined to produce a larger random sample of the population of interest.

2-1. Survey Methodology

International Communications Research's omnibus survey, called EXCEL, is a national twice-weekly telephone omnibus survey. Each survey consists of a minimum of 1,000 interviews, half with men and half with women. The survey uses a fully-replicated, stratified, single-stage random-digit-dialing sample of telephone households. Sample telephone numbers are computer generated and loaded into on-line sample files accessed directly by a computer assisted telephone interview system.[22] Within each sample household, one adult respondent is randomly selected using a computerized procedure based on the "Most Recent Birthday Method" of respondent selection.

Interviewing for each survey is conducted over a five-day period, encompassing both weekdays and weekends. Up to four attempts are made to a number on various days and at different time periods. The surveys achieve a response rate of about 30 percent. The relatively short field period precludes more extensive efforts to contact potential respondents. This limits the response rate that can be achieved on a survey.

Each survey questionnaire is composed of two distinct parts. The first part is the series of inserts containing sponsors' questions. Because of the broad range of subjects in any particular wave, an appropriate transitional statement introduces each section to ensure complete respondent understanding and attention. Placement of each insert is determined by overall question flow.

The second part of the questionnaire includes standard demographic and classification questions. The demographic characteristics are age, sex, education, employment status, race and ethnic background, marital status, and political affiliation. The household

[22] The primary disadvantage of a telephone survey is that it does not cover households that do not have a telephone. About six-percent of US households do not have a telephone. These households are more likely to be low income, minority, and in the south, than households with a telephone.

characteristics are household income; home ownership; sex, age, and relationship of household members to the respondent; and the number of telephone numbers serving the household.

Each survey can be weighted to provide nationally representative estimates of the adult population 18 years of age and older and of households. The weighting process takes into account the disproportionate probabilities of household selection due to the number of separate telephone lines and the probability associated with the random selection of an individual household member. Following application of the population or household weight, the sample is post-stratified and balanced by key demographics such as age, sex, region, and education.

2-2. Refund Anticipation Loan Questions

The insert containing the questions on refund anticipation loans was designed to provide information on demographic and economic characteristics that economic theory predicts are associated with use of high cost credit and on the decision process underlying the choice of a refund anticipation loan. Specifically, the insert addresses the following questions:

- What is the incidence of tax refund anticipation loans in the population and among certain segments of the population, such as recipients of the earned income tax credit?
- What are the demographic characteristics of refund anticipation loan customers?
- How knowledgeable are refund anticipation loan customers about the terms of the transaction?
- Are refund anticipation loan customers aware of alternatives for receiving tax refunds?
- What other types of credit do refund anticipation loan customers use?
- Do refund anticipation loan customers perceive limitations on their ability to obtain credit from other sources?
- To what extend are refund anticipation loan customers satisfied with the product?
- What are the reasons for satisfaction or dissatisfaction with refund anticipation credit?

The refund anticipation loan questions are listed in the appendix to this chapter.

The questions on credit use and experiences are similar to ones used by researchers at the Federal Reserve Board to study consumers' behavior. The use of similar questions allows comparisons of refund anticipation loan customers' credit behavior with that of all households. Data on household credit use were available from the Survey of Consumer Finances (see Aizcorbe, Kennickell, and Moore 2003). Additional benchmark data on bank card use and awareness annual percentage rates for bank cards were available from the January 2000 Survey of Consumer Attitudes (see Durkin 2000).

2-3. Interviewing

The refund anticipation loan insert was included in a total of 15 surveys conducted in March and April 2004. Interviewers screened 15,177 respondents in the 15 surveys for obtaining a refund anticipation loan based on their 2003 federal income tax refund. Of the 15,177 respondents screened, 330 had obtained a refund anticipation loan.

APPENDIX TO CHAPTER 2

Refund Anticipation Loan Questionnaire

Part A: 2003 Tax Return

RA-1. Have you completed your tax return for 2003?

1 Yes, completed
2 No, have not SKIP TO NEXT INSERT

(ASK RA-2 IF RA-1=YES)

RA-2. Did you (and/or your husband/wife) use a professional tax preparer to help you file your 2003 federal income tax return?

1 Yes
2 No
D Don’t know
R Refused

(ASK RA-3 IF RA-2=YES)

RA-3. What is the main reason you used a tax preparer to help you file your tax return? (DO NOT READ) (SINGLE RESPONSE)

01 Tax rules/forms complicated
02 Don’t understand tax rules/forms
03 Don’t have time to learn current tax rules
04 Tax preparer is able to obtain lower tax obligation than respondent
05 Tax preparer is less likely to make mistake/tax preparer more accurate.
06 Tax preparer is able to file electronically
07 Able to obtain a refund anticipation loan to get funds sooner
08 Able to get funds sooner
09 Have always use tax preparer to file tax returns
97 Other (SPECIFY)
DD (DO NOT READ) Don’t know
RR (DO NOT READ) Refused

RA-4. Did you claim an Earned Income Tax Credit on your 2003 federal income tax return? (IF NEEDED:) This is a credit available to taxpayers with household incomes of less than $33,600 in 2003.

1 Yes
2 No
D Don’t know
R Refused

RA-5. Are you eligible for a refund on your 2003 federal income tax return, whether or not this refund has been issued?

1	Yes	(CONTINUE)
2	No	(SKIP TO NEXT INSERT)
D	Don't know	(SKIP TO NEXT INSERT)
R	Refused	(SKIP TO NEXT INSERT)

RA-6. What is the total amount of the refund claimed on your 2003 federal income tax return? IF NECESSARY: Your best estimate is fine. (RECORD FULL DOLLAR AMOUNTS)

________________ (RECORD AMOUNT; RANGE 0 – 999,999)
DD Don't know
RR Refused

RA-7. Did the tax preparer offer the option of electronic filing for your 2003 federal income tax return?

1 Yes
2 No
D Don't know
R Refused

Part B: Refund Anticipation Loan

RA-8. Have you heard about a product called a Refund Anticipation Loan? This is a loan or advance of money against a tax refund, typically provided by a bank through a tax preparer.

1	Yes	(CONTINUE)
2	No	(SKIP TO NEXT INSERT)
D	Don't know	(SKIP TO NEXT INSERT)
R	Refused	(SKIP TO NEXT INSERT)

RA-9. Did you obtain a Refund Anticipation Loan based on your 2003 federal income tax refund?

1	Yes	(CONTINUE)
2	No	(SKIP TO NEXT INSERT)
D	Don't know	(SKIP TO NEXT INSERT)
R	Refused	(SKIP TO NEXT INSERT)

RA-10. What was the **main** reason that you obtained this Refund Anticipation Loan rather than wait for the government to refund your money? Was it to pay bills from Christmas, pay other credit card bills, pay for tax preparation, pay some unexpected expense, make a planned purchase, take advantage of a favorable purchase opportunity, or some other reason? (ENTER ONE)

01 Pay bills from Christmas
02 Pay credit card bills (not from Christmas)
03 Pay for tax preparation
04 Pay unexpected expenses
05 Make planned purchase
06 Take advantage of favorable purchase opportunity
97 Other (SPECIFY) ____________________
DD (DO NOT READ) Don't know
RR (DO NOT READ) Refused

RA-11. What was the dollar amount of the fee for preparing your 2003 federal income tax return? IF NECESSARY: Your best estimate is fine. (RECORD FULL DOLLAR AMOUNTS)

________________ (RECORD AMOUNT; RANGE 0 – 99,999)
DD Don't know
RR Refused

RA-12. What was the dollar amount of your Refund Anticipation Loan before the deduction of any fees? IF NECESSARY: Your best estimate is fine. (RECORD FULL DOLLAR AMOUNTS)

________________ (RECORD AMOUNT; RANGE 0 – 999,999)
DD Don't know
RR Refused

RA-13. What was the dollar amount of the fee charged for the Refund Anticipation Loan? IF NECESSARY: Your best estimate is fine. (RECORD FULL DOLLAR AMOUNTS)

________________ (RECORD AMOUNT; RANGE 0 – 99,999)
DD Don't know
RR Refused

RA-14. Were any other fees, such as fees for tax preparation or electronic filing, deducted from the Refund Anticipation Loan?

1	Yes	(CONTINUE)
2	No	(SKIP TO RA-16)
D	Don't know	(SKIP TO RA-16)
R	Refused	(SKIP TO RA-16)

RA-15. What other fees were deducted? (ENTER ALL THAT APPLY)

1 Tax Preparation
2 Electronic Filing
7 Other (SPECIFY) ____________________
D (DO NOT READ) Don't know
R (DO NOT READ) Refused

RA-16. How much did you receive after all fees were deducted? IF NECESSARY: Your best estimate is fine. (RECORD FULL DOLLAR AMOUNTS)

________________ (RECORD AMOUNT; RANGE 0 – 099,999)
DD Don't know
RR Refused

RA-17. Were you given an Annual Percentage Rate of interest for this Refund Anticipation Loan?

1	Yes	
2	No	(SKIP TO RA-19)
D	(DO NOT READ) Don't know	(SKIP TO RA-19)
R	(DO NOT READ) Refused	(SKIP TO RA-19)

RA-18. What was the Annual Percentage Rate that you were given? IF NECESSARY: Your best estimate is fine.

________________ (RECORD PERCENTAGE WITH ONE DECMAL)
00 (ZERO)
DD (DO NOT READ) Don't know
RR (DO NOT READ) Refused

RA-19. Before obtaining this refund anticipation loan, did you discuss with the tax preparer other options for getting your refund faster, such as electronic filing or receiving the refund by direct deposit in a checking or savings account?

1 Yes
2 No
D (DO NOT READ) Don't know
R (DO NOT READ) Refused

RA-20. How satisfied or dissatisfied were you with the refund anticipation loan—very satisfied, somewhat satisfied, somewhat dissatisfied, or very dissatisfied?

4 Very Satisfied
3 Somewhat Satisfied
2 Somewhat Dissatisfied
1 Very Dissatisfied
D (DO NOT READ) Don't know (SKIP TO RA-23)
R (DO NOT READ) Refused (SKIP TO RA-23)

(ASK IF RA-20 = 4 OR 3)
RA-21. Why do you say you were (IF RA-20= 4 INSERT "very"; IF RA-20= 3 INSERT "somewhat") satisfied? (DO NOT READ)

01 Received/needed money quickly
02 Reasonable fee/cost
03 Low fee/cost
04 Easy/convenient process
05 Little paperwork
06 Paid tax preparation fee
07 No out of pocket expenses
97 Other (SPECIFY)
D Don't know
R Refused

(ASK IF RA-20=2 OR1)

RA-22. Why do you say you were (IF RA-20= 1 INSERT "very"; IF RA-20= 2 INSERT "somewhat") dissatisfied? (DO NOT READ)

1 High Fee
2 High Interest Rate
3 High Cost, NA Whether Fee Or Interest Rate
4 Insufficient/Unclear Information
7 Other (SPECIFY) ____________________
D (DO NOT READ) Don't know
R (DO NOT READ) Refused

RA-23. Was this the first time you used a refund anticipation loan?

1	Yes	
2	No	(SKIP TO RA-25)
D	Don't know	(SKIP TO RA-25)
R	Refused	(SKIP TO RA-25)

RA-24. How many times have you obtained a refund anticipation loan in the past?

_______________ (RECORD NUMBER; 1- 99)
NN None/Never
DD (DO NOT READ) Don't know
RR (DO NOT READ) Refused

Part C: Other Credit Use and Perceived Alternatives

RA-25. Do you (or your husband/wife) have any major credit cards, such as Visa, MasterCard, Discover, or Optima cards?

1	Yes	(CONTINUE)
2	No	(SKIP TO RA-30)
D	Don't know	(SKIP TO RA-30)
R	Refused	(SKIP TO RA-30)

RA-26. How many different bank credit card accounts do you (and your husband/wife) have?

________________ (RECORD NUMBER; 1-99)
DD (DO NOT READ) Don't know
RR (DO NOT READ) Refused

RA-27. How often do you pay off the balance on your bank credit cards—always or almost always, sometimes, or hardly ever?

3 Always Or Almost Always
2 Sometimes
1 Hardly Ever
D (DO NOT READ) Don't know
R (DO NOT READ) Refused

RA-28. At any time in the last 12 months, were you unable to use your bank credit cards because you would have exceeded your credit limit?

1 Yes
2 No
D Don't know
R Refused

RA-29. What is the Annual Percentage Rate of interest on the bank card that you use the most?

________________ (RECORD PERCENTAGE WITH ONE DECIMAL)
DD (DO NOT READ) Don't know
RR (DO NOT READ) Refused

RA-30. Do you (or your husband/wife) have any (INSERT ITEM A-D). ROTATE ITEMS A-C; ASK D LAST

1 Yes
2 No
D Don't know
R Refused

a. Store or gasoline credit cards?
b. Automobile loans?
c. Mortgage loans?
d. Any other loans on which you are making regular payments?

CHECKPOINT

a. IF YES TO RA-25, RA-30a, RA-30b, OR RA-30d GO TO RA-31

b. IF NO, D, R TO [RA-25, RA-30a, RA-30b, AND RA-30d] AND [YES TO RA-3-c] GO TO RA-32

c. IF NO, D, R TO RA-25, RA-30a, RA-30b, RA30-c, AND RA-30d GO TO RA-33

RA-31. (Not including any mortgage loans), how much are your monthly payments on your credit card and other loans? IF NECESSARY: Your best estimate is fine. (RECORD FULL DOLLAR AMOUNTS)

________________ (RECORD AMOUNT; RANGE 0 – 099,999)
DD Don't know
RR Refused

RA-32. During the last 12 months, have you ever been more than 60 days late in making payments on any of your debts?

1 Yes
2 No
D Don't know
R Refused

RA-33. In the past 5 years, has a particular lender turned down any request you made for credit or not given you as much credit as you applied for?

1 Yes
2 No
D Don't know
R Refused

RA-34. Was there any time in the past 5 years that you thought of applying for credit at a particular place but changed your mind because you thought you might be turned down?

1 Yes
2 No
D Don't know
R Refused

RA-35. In the past 5 years, have you (or your husband/wife) INSERT ITEMS. ROTATE ITEMS.

1 Yes
2 No
D Don't know
R Refused

a. Obtained cash by pawning something at a pawnshop?
b. Obtained a payday advance?

Part D: Assets and Savings

RA-36. Do you (or your husband/wife) have a checking account?

1 Yes
2 No
D Don't know
R Refused

RA-37. Do you (or your husband/wife) have a savings, credit union share, or money market account?

1 Yes
2 No
D Don't know
R Refused

RA-38. How easy or difficult is it for you to save in advance to make purchases—would you say it is very easy, somewhat easy, somewhat difficult, or very difficult?

4 Very Easy
3 Somewhat Easy
2 Somewhat Difficult
1 Very Difficult
D (DO NOT READ) Don't know
R (DO NOT READ) Refused

RA-39. Which of the following three statements is closest to describing your (family's) saving habits? (CHECK ONE)

1 You don't save.
2 You save whatever is left over at the end of the month.
3 You regularly set aside money in savings
D (DO NOT READ) Don't know
R (DO NOT READ) Refused

RA-40. Do you withhold an extra amount of your income for taxes so that you will receive a refund after you file your tax return?

1 Yes
2 No
D Don't know
R Refused

RA-41. During the past year, have you used a check cashing company to cash checks?

1 Yes
2 No
D Don't know
R Refused

CHAPTER 3
CONSUMERS' DEMAND FOR CREDIT

Credit is not obtained as a good in itself. Rather credit is typically associated with the purchase of goods or services. Many goods and services purchased using credit provide utility over a period of time. Automobiles, furniture, appliances, and education are all examples of such goods or services. They are not used up immediately after purchase. Acquisition of goods and services that provide future utilities is not fundamentally different from investment. Indeed acquisition of such goods can be thought of as consumer investment. Consideration of the economic theory concerning consumer decisions in this area explains why consumers are sometimes willing to borrow at high rates of interest.

In their analysis of the consumer's credit decision, Juster and Shay (1964) noted the similarity of the consumer's decision to finance the purchase of household durable goods to business investment. The value of a stream of services from a durable, they suggested, can often be measured in terms of the cost of purchasing those services in the market. For example, the value of the services of a washing machine can be measured by the cost of obtaining the services in a Laundromat, or the services of an automobile can be measured by the cost of using public transport. Even the services of durables like televisions or video recorders can be valued in such a way. The value of services of a television, for example, can be measured by the cost of going to the cinema, a concert, or other entertainment activities that would be undertaken if television were not available.[23] This consideration facilitates comparisons of the benefits and costs of acquiring durables.

3-1. The Consumption/Investment Model and Credit Demand

The economist's model for analysis of such decisions is Fisher's intertemporal consumption/investment model (Fisher 1930). The consumption/investment model relates investment opportunities, time preference, and the interest rate to solve the problem of allocating resources over time. The solution provides an individual's optimal time pattern of consumption. In a perfect market, the consumer invests along among opportunities until the rate of return on investment is equal to the interest rate and then borrowing or lending at that rate to achieve the time pattern of consumption that provides the highest achievable utility level.

Juster and Shay extended Fisher's model to consider how certain institutional features of consumer credit markets affect consumer choices.[24] One extension involved Hirschliefer's (1958) then recent theoretical developments that addressed an imperfect capital market in which the interest rate for borrowing is greater than the interest rate for lending. In this market, the consumer invests among investment opportunities until the rate of return on investment is equated with the discount rate, which depending on

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[23] A few researchers have estimated rates of return for household durables using methods suggested by Juster and Shay. See Poapst and Walters (1964) and Dunkelberg and Stephenson (1975).

[24] These extensions are presented in appendix A of Juster and Shay's monograph.

circumstances may be the borrowing rate, lending rate, or the consumer's rate of time preference. The optimal time pattern of consumption is achieved by equating the discount rate to the rate of time preference by borrowing, lending, or neither.

Juster and Shay considered further extensions to the model to address two other institutional characteristics of consumer credit supply, which have been designated as credit or liquidity constraints in subsequent literature. The extensions address (1) borrowing opportunities in which larger amounts of borrowing have a higher marginal borrowing rate, and (2) borrowing opportunities with an absolute limit on the amount that can be borrowed. These extensions account for many lenders' unwillingness to finance the entire cost of consumer durables and the existence of specialized lenders offering unsecured credit at relatively high interest rates.

Many mainstream lenders reduce their exposure to default risk by requiring borrowers to repay the loan before the end of the service life of the durable. This requirement forces the borrower to build equity in the durable being financed, reducing default risk by making default costly to the borrower.[25] The equity requirement may also affect the cost of financing the durable because building equity forces the borrower to forgo current consumption. If the cost of forgoing current consumption is sufficiently high, borrowers sometimes may obtain additional credit by using unsecured personal credit, but this credit is riskier and therefore more costly than other forms of credit. For many consumers, additional unsecured personal credit is available only from specialized high-risk lenders at a substantially higher cost.[26] And at some point, a consumer may not be able to borrow additional amounts at all.

These further extensions lead to two types of outcomes, an equilibrium outcome and a rationing outcome. Consider a simple example in which there are two borrowing rates, a lower rate charged by primary lenders and a higher rate charged by secondary lenders. Both lenders have an absolute limit on the amount that can be borrowed. The equilibrium outcome is similar to the one in Hirschleifer's extension. The consumer invests in durables until the rate of return on investment is equated with the discount rate, which in a situation involving borrowing is the rate charged by primary lenders. The amount borrowed does not exceed the limit set by primary lenders, and the rate of return on investment, discount rate, and rate of time preference are equal.

Rationing outcomes occur when the consumer is unable to equate the rate of return on investment, discount rate, and rate of time preference. In some rationing outcomes, the consumer is able to equate the rate of return on investment and the rate of time preference. However, discontinuities in market opportunities for borrowing prevent the consumer from taking advantage of potentially utility increasing investments. Rationing

[25] They also typically retain a security interest in the durable. Many consumer durables used for collateral have little market value. They nevertheless may serve as collateral if they have value to the borrower (such as providing a stream of services). Loss of the durable would thus be costly to the borrower. See Barro (1976) or Benjamin (1978). See chapter 4 below for further discussion.

[26] See also Bizer and DeMarzo (1992) for a model of markets with sequential credit decisions.

prevents a consumer from borrowing further at a lower rate, and the return on investment is not sufficiently high enough to justify borrowing at the next higher available rate.

A second rationing outcome occurs when the consumer exhausts availability of credit at the lower rate charged by primary lenders and borrows at the higher rate. In this case the rate of return on investment is less than the consumer's rate of time preference. The rate of time preference may be equal to the higher rate charged by secondary lenders or greater than the higher rate if the amount of borrowing exceeds the secondary lenders' limit. Again, rationing prevents the individual from taking advantage of potentially utility increasing investments.

3-2. Consumer Characteristics Associated with Rationing

Juster and Shay identified characteristics that distinguish rationed and unrationed borrowers. Borrowers who have high rates of time preference and are constrained by equity requirements that limit amounts that can be borrowed were called "rationed" borrowers. Rationed borrowers typically are in early family life-cycle stages. They have relatively few durables and frequently have growing families. Consequently, rates of return on household investment tend to be high.[27] Rationed borrowers also have relatively low or moderate current incomes, making the sacrifices in current consumption necessary to satisfy creditors' equity requirements costly. And because of their moderate incomes and young early age, rationed borrowers generally have not accumulated large amounts of liquid assets. At this stage in the life cycle, precautionary motives loom large in consumers' saving decisions. Thus, their liquid asset holdings have a high subjective yield, which makes it costly to liquidate assets to acquire durables.[28] High rates of time preference and high subjective yields on liquid assets cause equity requirements to be expensive for rationed borrowers, making them willing to pay high interest rates to obtain more credit.

Unrationed borrowers, in contrast, typically are in later family life-cycle stages or have relatively high incomes. Unrationed borrowers in later life-cycle stages may have relatively few high-return household investment opportunities. And relatively high

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[27] Calculations by Poapst and Walters (1964) and Dunkelberg and Stephenson (1975) provide support for the view that rates of return on investment in household durables can be quite high, especially for families with children. Consumers' actual returns are likely higher that these studies estimate because the studies omit from the calculations factors such as greater flexibility in use of time, any special features not available from commercial alternatives, and the convenience of not having to leave the home.

[28] Subjective yields on liquid asset holdings are higher than nominal yields for many consumers because of strong precautionary motives. Many consumers use liquid assets grudgingly even when events occur that impair their earning potential or require large expenditures. Their reluctance to use liquid assets stems from a belief that the worse the current situation, the greater is the need to maintain reserves for future emergencies (Katona 1975). As a consequence, subjective yields on liquid assets are often substantially greater than nominal yields. This characteristic of consumers' financial behavior may explain consumers' simultaneous holding of consumer debt and relatively large amounts of liquid assets. The weighted average annual percentage rate on the outstanding consumer credit is greater than the nominal yield but less than the subjective yield on the liquid assets. Since many consumers who have relatively high-cost personal loans from finance companies or credit card debt also hold liquid assets is, the subjective yield on liquid assets is likely to be quite high for some consumers.

income may provide discretionary income that allows unrationed borrowers to satisfy equity requirements without costly reductions in current consumption. Moreover, their age and income may allow unrationed borrowers to accumulate relatively high levels of savings. Consequently, subjective yields on liquid assets are often substantially lower for unrationed borrowers than for rationed borrowers. Availability of low-cost discretionary income and liquid assets for acquisition of durables make unrationed borrowers unwilling to pay high interest rates for additional credit.

3-3. New Opportunities for Borrowing for Rationed Consumers

Consumer credit markets have changed considerably since Juster and Shay's study. Advances in information availability and in the technology to manage and analyze large amounts of information have improved lenders' ability to assess risk. Credit reporting is now close to comprehensive. Credit reports thus reflect a consumer's complete credit history, making information in credit reports more useful for predicting future payment performance. In addition, the development of credit bureau scores has made statistical credit evaluation available to all creditors.

Such changes have loosened the credit limits of primary lenders. Equity requirements have been relaxed, as terms to maturity have lengthened for most closed-end instalment credit. Downpayment requirements have also been reduced. And home equity lines of credit have been developed to allow consumers to finance acquisition of durables using the equity in their homes. Thus, many consumers are able to finance a greater proportion of their household investment through primary lenders.

Higher cost credit products from secondary lenders have also proliferated. Unsecured credit is now widely available through bank credit cards. Many borrowers use bank credit cards in much the same way as Juster and Shay described borrowers using unsecured personal loans (see Bizer and DeMarzo 1992, Brito and Hartley 1995). Competition extended availability of bank credit cards to many consumers who previously would have had difficulty qualifying for bank cards. As a result, unsecured credit is now available to more consumers at a lower cost than in the past.

Subprime products have also been developed for credit cards, automobile financing, and mortgages. These subprime products allow consumers to finance a larger share of the value of household durables, borrow more heavily against future income, or obtain credit despite previous problems repaying debts.

Various short-term credit products have also been developed. The payday advance industry allows consumers to obtain an advance on their next paycheck. Similarly, refund anticipation loans enable consumers to obtain an advance on expected tax refunds. Short-term products may facilitate the accumulation of household assets even when they are not used directly to finance household investment. The availability of short-term credit may reduce consumers' vulnerability to unexpected expenses or reductions in income when consumers use relatively large amounts of debt to finance household investment. Although these short-term credit products may be very costly, consumer losses resulting from a lack of liquidity may be quite large. Thus, short-term products may also have expanded the opportunities for rationed consumers to finance household investment.

3-4. The Decision to Use a Refund Anticipation Loan

The consumption/investment model yields the familiar net present value rule for evaluating investments. That is, a transaction increases utility (or wealth) and is therefore beneficial if the present value of the flow of benefits produced by the transaction exceeds the transaction's cost. The borrowing rate is the discount rate for valuing future benefits. Typically, the transaction is the acquisition of a household durable. In the case of short-term credit, the transaction may involve avoiding fees, a penalty for late payments, the cost of delaying a necessary expenditure, or forgoing a favorable purchase opportunity.

Elliehausen and Lawrence (2001) provide examples using the net present value rule to evaluate the use of short-term credit to avoid late fees and to avoid delaying repair of an automobile. The examples show that such transactions may have a positive net present value even at discount rates that correspond to annual percentage rates of nearly 400 percent.

Table 3-1 presents calculations of the net present value of using a credit to obtain a benefit a short time in the future by loan size and amount of benefit. This type of transaction might involve using the proceeds of the refund anticipation loan to pay bills now rather than paying bills late plus late payment fees for failure to make timely payment. A more positive example might be buying an item on sale now rather than paying full price later. The net present value (NPV) of the transaction would be calculated as follows:

$$\text{NPV} = -C + F/(1 + r),$$

where C is the current cost (the amount of the bill or the sale price), F is the future cost (the amount of the bill plus avoided late payment fee or the regular price of the item), and r is the discount rate. Net present values are calculated for selected undiscounted benefit (that is, avoided fees or savings) amounts ranging from \$25 to \$125. The discount rate, based on the fee schedule in table 1-1, is calculated by dividing the refund anticipation loan fee by the loan amount.[29] A positive value indicates that the benefit exceeds the cost of the transaction.

Consider, for example, a consumer who has a choice between purchasing an appliance for \$2,000 in a limited time-period sale and waiting ten days or longer (until receipt of a tax refund) to purchase the appliance at the regular price of \$2,100. The net present value of using a refund anticipation loan to take advantage of the sale is obtained by subtracting the sale price from the full price discounted at the 4.5 percent rate for a \$2,000 refund anticipation loan. That is, NPV = -\$2,000 + \$2,100/(1 + 0.045) = \$10.53. The calculation indicates that after accounting for the cost of credit, the benefit of using a refund anticipation to take advantage of the sale is positive. This result means that using

[29] Note that in Truth in Lending the discount rate is the periodic rate, which is multiplied by the number of periods in a year to obtain the annual percentage rate.

a refund anticipation loan to purchase the appliance on sale is less costly than waiting for a tax refund and paying the regular price.[30]

Table 3-1
Net Present Value of Refund Anticipation Loan, By Size of Refund Anticipation Loan and Amount of Saving or Avoided Loss
(Dollars)

RAL amount	RAL fee	Discount rate	Benefit (savings or avoided loss) $25	$50	$75	$100	$125
$300	$34	11.3%	-8.08	14.37	36.83	59.28	81.74
$750	$49	6.5%	-22.53	0.94	24.41	47.87	71.34
$1,250	$59	4.7%	-32.47	-8.59	15.28	39.15	63.03
$1,750	$74	4.2%	-47.01	-23.03	0.96	24.95	48.93
$2,000	$89	4.5%	-61.27	-37.34	-13.40	10.53	34.47
$4,000	$89	2.2%	-62.61	-38.15	-13.70	10.76	35.22

Other situations would produce different results. If the savings from purchasing the appliance on sale were only $75, a negative net present value (-$13.40) would be obtained. In this case, the consumer would be better off waiting for the tax refund and paying the regular price than using a refund anticipation loan to purchase the appliance on sale.

These examples are hypothetical, of course. The net present value of any transaction depends upon the situation. Generalization is difficult when many transaction-specific calculations are possible. Nevertheless, that there are situations in which use of high-cost short-term credit may be beneficial is quite plausible when one considers the size of many fees and penalties for late payments or the prevalence of promotions and sales in retailing.

Few, if any, consumers will actually use the net present value rule to evaluate use of a refund anticipation loan. Consumers will simply subtract the cost from the benefit without discounting. The amount of the transaction is generally relatively small, and the expected term of the loan is very short. The effect of discounting is therefore small, even at discount rates that are relatively high when stated on an annual basis. In many cases, an undiscounted net value rule would lead to the same decision as the net present value rule. And when the undiscounted net value rule would lead to a different decision, the dollar amount involved would be relatively small.

Table 3-2 illustrates differences between the net present values from table 3-1 and undiscounted net values. The differences are less than one percent of the loan amount in all but the last three columns in row one (where the differences are 1.4, 2.2, and 3.1 percent of the loan amount). In none of these cases, would the undiscounted net value rule lead to a different decision than the net present value rule.

[30] Table 3-1 does not include any flow of services from the purchase during the time interval, nor does the table consider any non-pecuniary benefits such as convenience or reputation.

Table 3-2
Differences between Net Present Value and Undiscounted Net Value Rules, By Size of Refund Anticipation Loan and Amount of Saving or Avoided Loss
(Dollars)

RAL amount	RAL fee	Discount rate	Net present value minus undiscounted net value $25	$50	$75	$100	$125
$300	$34	11.3%	0.92	-1.63	-4.17	-6.72	-9.26
$750	$49	6.5%	1.47	-0.06	-1.59	-3.13	-4.66
$1,250	$59	4.7%	1.53	0.41	-0.72	-1.85	-2.97
$1,750	$74	4.2%	1.99	0.97	-0.04	-1.05	-2.07
$2,000	$89	4.5%	2.73	1.66	0.60	-0.47	-1.53
$4,000	$89	2.2%	1.39	0.85	0.30	-0.24	-0.78

3-5. Alternatives for Short-Term Financing

Some rationed consumers may have alternatives for financing transactions. They should evaluate alternatives in the same way as they evaluate the refund anticipation loan transaction–comparing the outlay with the present value of benefits, using the cost of the source for the discount rate in the present value calculation. However, there may be psychological considerations that cause the nominal and subjective costs of some alternatives to diverge. These considerations include precautionary motives for saving and a lack of self-control in budgeting.

Many rationed borrowers will have some savings, even if limited. They often borrow rather than use savings for purchases, despite the higher interest rate for borrowing. As mentioned, this behavior may be explained by a precautionary motive for saving, which makes the subjective yield from savings exceed the nominal rate of interest. Katona (1975) noted that many consumers are reluctant to use liquid assets when events occur that impair their earning potential or require large expenditures. Their reluctance stems from a belief that however bad the current situation, the need for reserves for future emergencies is greater.[31] The perceived need to save for future emergencies makes the subjective yield on savings exceed their nominal yield. This perception is common since most consumers simultaneously hold both liquid assets and owe debt. For many the perception appears quite strong since they have credit card debt or personal loans from finance companies and also hold liquid assets. This behavior suggests that the subjective yield on liquid assets for these consumers is likely to be quite high.

A perceived lack of self-control may also make some consumers reluctant to draw against their liquid assets. Consumers perceiving a lack of self-control believe that they do not have the discipline to replenish the depleted assets after they have drawn against them. Using a refund anticipation loan instead of savings to pay unexpected bills or to take

[31] Consumers' response to accelerating inflation provides an example of the strength of consumers' precautionary motive for saving. With the recognition of the accelerating inflation in the 1970s, many consumers added to their liquid assets at a time when the yields available to them on savings were less than the rate of inflation. They did so despite the loss in value of savings and the higher cost of deferred purchases. For these consumers, the uncertainty associated with inflationary economy outweighed the loss in value of their assets. See Katona (1973).

advantage of sale avoids a situation in which a lack of self-control might conflict with the consumer's precautionary savings goals.[32] This behavior is very costly, but there is considerable evidence that many consumers are willing to pay to be protected against their own bad habits (Katona 1975).

Credit cards are a potentially attractive source of short-term financing because the transaction cost of obtaining credit is zero. The psychological consideration that makes consumers reluctant to draw upon their savings may also make some consumers reluctant to borrow using a credit card. Gross and Souleles (2002) and Bird and Hagstrom (2001) present evidence suggesting that consumers maintain target levels of unused credit limits. The unused credit limits are an option against which a cardholder can draw in an emergency. Like liquid assets, unused credit card limits may be held for precautionary reasons, to be drawn against in the future if other options are not available. In such cases, the subjective cost of borrowing beyond the target level would be greater than the nominal interest rate. For consumers with relatively low credit limits, the subjective cost may be much greater than the nominal interest rate.

Perhaps a greater deterrent to using credit cards may be a perceived lack of self-control. The low minimum-payment requirement for credit cards—usually two percent of the balance or less—provides little discipline to repay debt. Consumers who perceive lack of self-control may fear that they will make only the minimum monthly payment resulting in a higher level of debt in the long run than they prefer (Katona 1975). Using a refund anticipation loan to enforce discipline may be costly, but perhaps in the absence of budgetary discipline is less costly than the exposure of increased vulnerability to higher debt levels over the long run.

[32] A lack of self-control is sometimes attributed to hyperbolic discounting. With hyperbolic discounting, consumers discount benefits in the near future at a higher rate than benefits in the distant future (Frederick, Loewenstein, and O'Donoghue 2002). As a result, consumers may act impatiently and make choices in the short-run that are inconsistent with their long-run goals. Some consumers may take actions to constrain behavior to be consistent with long-run goals (Thaler and Shefrin 1981). For example, consumers who have difficulty saving for durables have used instalment credit to force budgeting their money, saving via debt repayment rather than frittering future income on the numerous goods and services that are available in the market. Other types of arrangements used to force oneself to budget money include whole life insurance, lay-away plans, and Christmas club accounts.

CHAPTER 4
DEMOGRAPHIC CHARACTERISTICS AND CREDIT USE OF REFUND ANTICIPATION LOAN CUSTOMERS

In 2004, 51.7 percent of households responding to the omnibus survey used a tax preparation service to prepare their 2003 federal income taxes. Sixty-seven percent of these households claimed a refund. A very small percentage of households obtained a refund anticipation loan despite widespread awareness of the product. Sixty-six percent of households using a tax preparation service and claiming a refund had heard of refund anticipation loans, but only 7.9 percent of households using a tax preparation service and claiming a refund actually obtained one.

This chapter examines demographic characteristics and credit use of these refund anticipation loan customers. The demographic characteristics considered are income and family life cycle, characteristics that the economic analysis in chapter 3 suggests are associated with high demand for credit. Households using a tax preparation service and the population of all households are used as benchmarks.

The chapter then looks refund anticipation loan customers' use of other types of credit for evidence that refund anticipation loan customers are "rationed." As discussed in chapter 3, many such consumers may be forced to forgo potentially desirable household investment opportunities because of limits to credit availability.

4-1. Demographic Characteristics

Refund anticipation loan customers are drawn predominately from income, age, and family-life-cycle groups that economic theory and evidence suggests are "rationed" at the interest rates charged by primary lenders.

Household Income

Refund anticipation loan (RAL) customers are disproportionately from lower or moderate-income households. Nineteen percent of refund anticipation loan customers in 2004 had incomes less than $15,000 (table 4-1). This percentage is not different from the overall percentage of households with incomes less than $15,000. The percentage of refund anticipation customers with incomes less than $15,000 is somewhat greater than the percentage of households with incomes less than $15,000 that use a tax preparation service, however.

Use of refund anticipation loans is relatively greatest in the $15,000-24,999 and $25,000-39,999 income groups. Twenty-eight percent of refund anticipation loan customers had incomes between $15,000 and $24,999, compared to 15.8 percent of households using a tax preparation service and 15.1 percent of households overall. Similarly, 27.4 percent of refund anticipation loan customers had incomes between $25,000 and $39,999, compared to 22.1 percent of households using a tax preparation service and 20.1 percent of households overall.

Not surprisingly, higher income households were less likely to obtain refund anticipation loans than low- or moderate-income households. Nevertheless, a small proportion of higher income households obtained refund anticipation loans. About one in nine households with incomes between $50,000 and $74,999 and one in twenty-five households with incomes of $75,000 or more obtained refund anticipation loans in 2004.

Table 4-1
Household Income of Refund Anticipation Loan Customers
(Percent)

	RAL customers	Households using tax preparer	All households
Less than $15,000	18.6	12.2	19.3
$15,000-24,999	27.9	15.8	15.1
$25,000-39,999	27.4	22.1	20.1
$40,000-49,999	11.4	11.7	10.5
$50,000-74,999	10.8	17.5	16.2
$75,000 or more	4.0	20.8	18.7
Total	100.0	100.0	100.0

Age and Family Life-Cycle Stage
Refund anticipation loan customers are predominately young, consistent with the hypothesis that consumers in the early years of household formation are more likely to be rationed than consumers in later stages of the family life cycle. Nearly half (47.8 percent) are between 25 and 34, an age group in which many households start families (table 4-2). All but a small percentage (13.7%) of refund anticipation loan customers are under 45 years of age.

Table 4-2
Age of Refund Anticipation Loan Customers
(Percent)

	RAL customers	Households using tax preparer	All households
Under 25 years	13.2	7.3	10.0
25-34 years	47.8	19.3	18.6
35-44 years	25.4	21.9	21.3
45-54 years	10.4	19.6	18.4
55-64 years	1.7	14.4	13.6
65 years or older	1.6	17.6	18.1
Total	100.0	100.0	100.0

The 86.3 percent of refund anticipation loan customers under 45 is far greater than the percentage of the households headed by persons under 45. Only about half of all households are headed by persons under 45. Also only about half of households using a tax preparation service are headed by persons under 45.

Family life-cycle stage includes consideration of age, marital status, and the presence of children in the household. About three-fourths of refund anticipation loan customers are in one of two life-cycle groups. The first group consists of consumers under age 45 who are married and have children. Forty-seven percent of refund anticipation loan customers are in this family life-cycle stage (table 4-3). The percentage of refund anticipation loan customers in this life-cycle group is over twice the life-cycle stage group's 19.5 percent representation among all households. The percentage of this group using a tax preparation service is not much different from that for all households.

Table 4-3
Family Life-Cycle Stage of Refund Anticipation Loan Customers
(Percent)

	RAL customers	Households using tax preparer	All households
Age less than 45			
Unmarried, no children	8.1	9.7	13.7
Married, no children	4.8	7.4	8.0
Married, with children	47.2	22.4	19.2
Age 45 or greater			
Married, with children	2.0	5.9	5.1
Married, no children	4.2	23.4	20.2
Unmarried, no children	5.4	20.1	22.3
Any age			
Unmarried, with children	28.3	11.1	11.5
Total	100.0	100.0	100.0

The second life-cycle group consists of consumers of any age who are unmarried and have children. Twenty-eight percent of households with refund anticipation loans are in this life-cycle group. This percentage is also over twice this life-cycle group's representation among all households. This group's use of a tax preparation service also does not differ from that of all households.

Many consumers in these life-cycle groups are likely to have characteristics associated with "rationing." The first group—age less than 45, married, with children—is relatively young. Because of their age, these consumers may not have accumulated large stocks of household durables. The low stock of existing durables together with a larger family size due to the presence of children may lead to relatively high returns from new household investment. However, these consumers may have limited ability to service additional debt to finance household investment because they have not achieved their peak earning years. They may also not have had time to accumulate large amounts of liquid assets.

The second group—any age, unmarried, with children—is also relatively young, although some older family heads are included. They too tend to have relatively low stocks of household durables and relatively high returns from household investment, have not achieved peak earning years, and accumulated large amounts of liquid assets. Unmarried consumers with children may have even more limited resources than consumers in the first group. Families with unmarried heads and children may have difficulty increasing income by working more and often have high expenses because of the need for child care.[33]

Table 4-4 shows distributions of income of refund anticipation loan customers in selected family life-cycle groups. Among consumers under age 45 who are married and have children, refund anticipation loan customers are disproportionately in income groups under $40,000 (table 4-4). Most refund anticipation loan customers in this life-cycle stage do not have low incomes, however. Nearly a third of refund anticipation loan customers who are under age 45, married, and have children have incomes between $25,000 and $39,999; and a third have incomes of $40,000 or more. Refund anticipation loan customers in this life-cycle stage are primarily from moderate-income households, which are relatively heavy users of consumer credit.[34]

Table 4-4
Income of Refund Anticipation Loan Customers and All Households in Selected Family Life-Cycle Stage and Income Groups
(Percent)

	Income				
	Less than $15,000	$15,000 -24,999	$25,000 -39,999	$40,000 or more	Total
Less than 45, married, with children					
RAL customers	14.6	20.7	31.1	33.6	100.0
All households	8.8	11.2	19.2	60.9	100.0
Any age, unmarried, with children					
RAL customers	30.1	34.8	21.8	13.4	100.0
All households	30.6	20.8	22.2	26.4	100.0
Other life-cycle stage					
RAL customers	8.0	37.6	24.9	29.4	100.0
All households	20.5	15.3	20.0	44.2	100.0
Any life-cycle stage					
RAL customers	17.6	28.8	26.9	26.7	100.0
All households	19.3	15.1	20.1	45.5	100.0

Unmarried consumers with children have lower incomes than households generally. Refund anticipation loan customers in this life-cycle group also have lower incomes than the population. Nearly a third of refund anticipation loan customers who are unmarried and have children have incomes less than $15,000. However, this share is about the same

[33] By far most earned income tax credit recipients are in family life-cycle groups that are associated with strong demand for credit. See the appendix to this chapter for statistics.
[34] See Lansing *et al*. (1956) for discussion characteristics of consumers using relatively large amounts of credit. See Aizcorbe, Kennickell, and Moore (2003) for recent data on characteristics of credit users.

as the share of all unmarried consumers in this life-cycle group with incomes less than $15,000. Refund anticipation loan customers who are unmarried and have children are disproportionately in the $15,000-24,999 and $25,000-39,000 income groups.

Among consumers in all other life-cycle groups, refund anticipation loan customers are disproportionately in the $15,000-24,999 and $25,000-39,000 income groups. Few refund anticipation loan customers in other life-cycle stages have very low income. Only 8.0 percent of these customers have incomes less than $15,000, compared to 20.5 percent of all households in other life-cycle groups.

In sum, use of refund anticipation loans is concentrated in income, age, and family life-cycle groups in which demand for credit is strong and availability of resources to service debt are limited. Refund anticipation loan customers are not drawn disproportionately from the lowest or highest income groups. They also are not very commonly drawn from older age groups. The next section examines whether or not refund anticipation loan customers' use of other types of credit is consistent with the hypothesis that they face constraints in the credit market.

4-2. Credit Use

This section examines refund anticipation loan customers' use of other types of credit. Two benchmarks—all households and payday advance customers—are used. Payday advance customers are a benchmark because they too use very short-term, high-cost credit. Payday advance customers typically have moderate incomes and are early family life-cycle stages (Elliehausen and Lawrence 2001). Like refund anticipation loan customers, payday advance customers also tend to be "rationed." Hence, refund anticipation loan customers credit use is likely to be closer to that of payday advance customers than households generally.

Use of Selected Types of Credit

Closed-end credit is the traditional type of consumer credit. This type of credit imposes the discipline of regularly scheduled monthly payments and often requires that the consumer build equity in the goods being financed to ensure repayment. As discussed in chapter 3, this feature causes some consumers to be rationed.

Refund anticipation loan customers are more likely to use closed-end consumer credit than households generally. Forty-one percent of refund anticipation loan customers had an automobile loan, and 28.1 percent had other closed-end consumer instalment loans—compared to 35.5 percent of households with automobile loans and 21.4 percent of households with other closed-end consumer instalment loans (table 4-5). This finding is consistent with the refund anticipation loan customers being primarily in early life-cycle stages for which demand for credit is high.

Open-end consumer credit is a riskier product than closed-end consumer credit. Once an open-end account is approved, consumers are able to borrow at their discretion. Much of open-end consumer credit is unsecured. Payments on open-end debt are largely discretionary. Only a very small percentage of the outstanding debt is typically required each month. These characteristics provide little discipline to repay open-end debt. Because of their credit risk, rationed borrowers may have difficulty qualifying for open-end credit, despite the recent development of a subprime market for bank cards and increases in bank card holding among low-income households.

Refund anticipation loan customers were less likely than all households to use open-end credit. Thirty-nine percent of refund anticipation loan customers had a bank card, and 15.0 percent had a retail card—compared to 72.5 percent of households with bank cards and 56.8 percent of households with retail cards. The greater percentage of lower income consumers among refund anticipation loan customers than households overall suggests that refund anticipation loan customers may have greater credit risk and therefore have greater difficulty qualifying for open-end credit.

Table 4-5
Use of Mortgage and Consumer Credit
(Percent)

	RAL customers	Payday advance customers	All households
Closed-End Consumer Credit			
Automobile loan	40.8	52.9	33.5
Other consumer instalment loan	28.1	36.6	21.4
Open-End Consumer Credit			
Bank card	39.0	56.5	72.5
Retail card	15.0	21.5	56.8
Mortgage	28.1	32.0	44.6

Refund anticipation loan customers were less likely than households overall to owe mortgage debt. This finding results from refund anticipation loan customers being less likely than all households to own homes.[35] Sixty-seven percent of refund anticipation loan customers who are homeowners and 65.9 percent of all households who are homeowners owe mortgage debt.

Refund anticipation loan customers' credit use was in many cases similar to experience of payday advance borrowers. Payday advance customers were also more likely to use closed-end consumer credit and less likely to use open-end credit than households generally. The observation that refund anticipation loan and payday advance customers are more likely to use closed-end credit is consistent with the expectation that refund anticipation loan and payday advance customers are rationed. That fewer refund

[35] Forty-two percent of refund anticipation loan customers (number not in table) and 67.7 percent of all households (Aizcorbe, Kennickell, and Moore 2003, p. 19) are homeowners. This result may be explained by the large percentages of refund anticipation loan customers in early life-cycle stages and in lower income groups. Many of these consumers likely have not accumulated sufficient assets to afford a downpayment on a house.

anticipation loan customers than payday advance customers use such credit may be explained in part by refund anticipation loan customers' lower income.

Another factor explaining the lower percentage of refund anticipation loan customers using closed-end consumer credit is that a large percentage of refund anticipation loan customers do not have a bank account. A quarter of refund anticipation loan customers do not have a checking or savings account (number not in table).[36] Refund anticipation loan customers without a bank account were much less likely than those with an account to use credit (table 4-6). This finding suggests that many refund anticipation loan customers have difficulty qualifying for a loan from a mainstream financial institution or do not want to do business with mainstream financial institutions.

Table 4-6
Refund Anticipation Loan Customers' Use of Mortgage and Consumer Credit, By Ownership of a Bank Account
(Percent)

	Has bank account	Does not have bank account	All RAL customers	Payday advance customers
Closed-End Consumer Credit				
Automobile loan	46.9	22.7	40.8	52.9
Other consumer instalment loan	31.6	17.7	28.1	36.6
Open-End Consumer Credit				
Bank card	49.5	8.0	39.0	56.5
Retail card	18.5	4.7	15.0	21.5
Mortgage	32.4	15.0	28.1	32.0

All payday advance customers have a bank account.[37] Credit use of refund anticipation loan customers who have a bank account was close to that of payday advance customers.

Consumer Debt Payment Burdens
Levels of indebtedness are commonly measured relative to income, using the ratio monthly debt payments to monthly income, since most consumer debt is repaid in monthly instalments. Table 4-7 shows the distribution of the consumer debt payment-to-(before tax) income ratio of refund anticipation customers, payday advance customers and all households who owe consumer debt.[38] Refund anticipation loan customers have higher consumer debt payments relative to income than households generally. Twelve percent of refund anticipation loan customers have consumer debt payment-to-income ratios of 0.30 or more (that is, monthly debt payments that are 30 percent or more of their

[36] Thirteen percent of all households do not have a checking account (Aizcorbe, Kennickell, and Moore 2003, p. 10).
[37] All payday advance customers have a checking account. A checking account is required to obtain a payday advance.
[38] Mortgage debt is excluded because of difficulties in defining comparable total debt payment-to-income ratios for renters and homeowners. See Dynan, Johnson, and Pence (2003) for discussion.

monthly income), compared to only 5.3 percent of households generally. And 25.2 percent (11.7 plus 13.5 percent) of refund anticipation loan customers have debt payment-to-income ratios of 20 percent or more, compared to 9.8 percent of all households. These results corroborate earlier conclusions that many refund anticipation loan customers are likely have relatively large amounts of debt and therefore face rationing in credit markets for further credit.

Table 4-7
Consumer Debt Payment-to-Monthly Income Ratio
(Percent of those owing consumer debt)

	RAL customers	Payday advance customers	All households
Less than 0.10	47.6	52.7	74.5
0.10-0.19	27.2	19.9	15.8
0.20-0.29	13.5	8.9	4.5
0.30 or more	11.7	18.5	5.3
Total	100.0	100.0	100.0

The distribution of consumer debt payment-to-income ratios of payday advance customers provides further corroboration for the rationing hypothesis. Like refund anticipation loan customers, these high-cost credit users also are more than twice as likely as households generally to have high consumer debt payment-to-income ratios.

Credit Availability
To investigate further the question of credit availability, refund anticipation loan customers were asked whether they had applied for credit in the last five years and had been turned down or offered less credit than the amount for which they had applied. Forty-seven percent of refund anticipation loan customers responded that they had been turned down or limited (table 4-8). This percentage is about two times greater than the 21.8 percent of all households that reported being turned down or limited in the last five years.

Table 4-8
Perceptions of Credit Availability
(Percent)

	RAL customers	Payday advance customers	All households
Turned down or limited in last five years	46.5	73.0	21.8
Did not apply for credit because thought might be turned down	48.2	67.7	14.3

Refund anticipation loan customers were also asked if they had considered applying for credit but changed their mind because they thought that they would be turned down. Nearly half of refund anticipation customers responded affirmatively to this question, more than three times the proportion of all households that did not apply because they thought that they would be turned down.

Responses to these questions indicate that more than half of refund anticipation loan customers had experienced or perceived limitations in credit availability. These credit market experiences and perceptions of refund anticipation loan customers are similar to those of payday advance customers, who are also users of high-cost, short-term credit.

Other Credit Market Experiences

Many refund anticipation loan customers have other characteristics associated with heavy credit use, credit problems, and limited credit availability. Of the two in five refund anticipation loan customers with a bank credit card, 60.2 percent reported hardly ever paying the full balance on their bank credit cards.[39] A third of refund anticipation loan customers with bank credit cards said that they did not use a bank credit card in the last year because they would have exceeded their credit limit. These statistics suggests that many refund anticipation loan customers have relative high utilization rates for their bank credit cards, a factor that is associated with serious delinquencies and therefore low credit bureau scores.

Refund anticipation loan customers were about four times more likely to have a serious delinquency on a mortgage or consumer debt during the previous year. Twenty-six percent of refund anticipation loan customers had a delinquency of 60 or more days, compared to 7.0 percent of all households account (Aizcorbe, Kennickell, and Moore 2003, p. 29). Serious delinquencies limit availability of credit at many lenders.

Many refund anticipation loan customers also borrow from other high-cost, short-term lenders. Thirty-six percent of refund anticipation loan customers used at least one of these two lender types in the previous five years: 23.4 percent borrowed from a pawnshop, and 18.0 percent borrowed from a payday advance company. Consumers using these types of credit often have few options for borrowing.

4-3. Saving Attitudes of Refund Anticipation Loan Customers

Refund anticipation loan customers are less likely than consumers overall to save regularly and more likely to save what is left over or not save at all. Thirty-three percent of refund anticipation loan customers said that they regularly set money aside for savings, compared to 42.5 percent of all households (table 4-9). In contrast, 39.9 percent of refund anticipation loan customers said that they saved what is left over at the end of the month, compared with 36.5 percent of all households; and 27.6 percent of refund anticipation customers said that they do not save, compared with 21.0 percent of all households.

[39] Thirty percent of all households with bank credit cards report hardly ever paying the bank credit card balances in full.

Table 4-9
Saving habits
(Percent)

	RAL customers	All households
Do not save	27.6	21.0
Save residual	39.9	36.5
Regularly save	32.5	42.5
Total	100.0	100.0

Nearly half of refund anticipation loan customers said that is very difficult (18.4 percent) or somewhat difficult (29.8 percent) to save in advance to make purchases (table 4-10). This attitude is consistent with relatively heavy reliance on credit, which characterizes rationed borrowers.

Table 4-10
Ease/Difficulty of Saving
(Percent)

	RAL customers
Very easy	24.0
Somewhat easy	27.9
Somewhat difficult	29.8
Very difficult	18.4
Total	100.0

Consumers who have difficulty saving may make take actions that force saving. Quite a large percentage of refund anticipation loan customers used tax withholding as a means of forcing saving. A third of customers reported that they had extra amounts withheld in order to get a tax refund (number not in tables). This action may be costly, particularly when used with a refund anticipation loan. However, there are other examples of consumers making arrangements to protect themselves against their own bad habits. For example, consumers forgo yield on liquid assets when they use products such as Christmas club accounts, whole life insurance, lay-away financing to prevent themselves from spending their own money (see Katona 1975).

4-4. Summary

The greater proportion of refund anticipation loan customers is in an early stage of the family life-cycle, in which demand for credit is high. By far most have low or moderate income. High credit use and limited resources for repaying debt leads to credit rationing by lower cost primary lenders. Evidence presented in this chapter suggests that many refund anticipation loan customers use relatively large amounts of consumer credit. Most refund anticipation loan customers have recently experienced loan turndowns or believe that they would be turned down.

Refund anticipation loan customers have few options for short-term loans. A large percentage of refund anticipation loan customers have a bank credit card, but bank card credit may not always be available for many of these customers. More than half of refund anticipation loan customers who have bank cards report that they hardly ever pay bank card balances in full, and a third said that they did not use a bank card in the last year because they would exceed their credit limit.

Several other characteristics also suggest limited options for borrowing. A quarter of refund anticipation customers do not have a bank account, which may make qualifying for a loan more difficult. A quarter of refund anticipation loan customers had serious delinquencies on a mortgage or consumer credit account in the previous year, which limits availability of credit at many lenders. Quite a large percentage of refund anticipation loan customers obtained credit from a pawnshop or a payday advance company during the previous five years. That these refund anticipation loan customers actually used one of these sources of high-cost, short-term credit suggests that these customers may have few alternatives.

APPENDIX TO CHAPTER 4

Refund Anticipation Loan Use by Earned Income Tax Credit Recipients
Among households using a tax preparation service and claming a federal income tax refund in 2004, earned income tax credit recipients were more likely than households overall to have obtained a refund anticipation loan: 18.5 percent of earned income tax credit recipients obtained a refund anticipation loan, compared to 7.9 percent of all households. The higher incidence of refund anticipation loan use by earned income tax credit recipients may be attributable to family life-cycle cycle considerations and credit rationing.

Earned income tax credit (EITC) recipients are disproportionately in early stages of the family life cycle that are associated with high demand for credit. Thirty-six percent of earned income tax credit recipients are less than 45 years of age, are married, and have children, compared to 19.2 percent of all households; and 42.1 percent of earned income tax credit recipients are any age, are unmarried, and have children, compared to 11.5 percent of all households (table A4-1).

Table A4-1
Earned Income Tax Credit Recipients, Refund Anticipation Loan Customers, and All Households, By Family Life-Cycle Stage
(Percent)

	EITC recipients obtaining RALs	EITC recipients	All RAL customers	All households
Age less than 45				
Unmarried, no children	<0.05	7.2	8.1	13.7
Married, no children	0.9	3.9	4.8	8.0
Married, with children	53.0	35.8	47.2	19.2
Age 45 or greater				
Married, with children	3.0	5.8	2.0	5.1
Married, no children	0.3	4.9	4.2	20.2
Unmarried, no children	0.7	8.4	5.4	22.3
Any age				
Unmarried, with children	42.1	34.1	28.3	11.5
Total	100.0	100.0	100.0	100.0

Like refund anticipation loan customers overall, by far most earned income tax credit recipients using refund anticipation loans are in early family life-cycle stages. Over half of earned income tax credit recipients are in the less than 45 years of age, married, with children life-cycle group, and 42.1 percent of earned income tax credit recipients in the any age, unmarried, with children group.

The income limits for the earned income tax credit together with the generally early life-cycle stage suggest that the typical earned income tax credit recipient is credit constrained. Earned income credit tax recipients were less likely than refund anticipation loan customers overall to use various different types of credit (table A4-2). And except for other closed-end consumer instalment loans, earned income credit tax recipients were also less likely than all households to use various different types of credit.

Table A4-2
Use of Mortgage and Consumer Credit by Earned Income Tax Credit Recipients, Refund Anticipation Loan Customers, and All Households
(Percent)

	EITC recipients obtaining RALs	All RAL customers	All households
Closed-End Consumer Credit			
Automobile loan	30.9	40.8	33.5
Other consumer instalment loan	23.8	28.1	21.4
Open-End Consumer Credit			
Bank card	31.2	39.0	72.5
Retail card	9.8	15.0	56.8
Mortgage	19.6	28.1	44.6

A lack of a banking relationship may hinder earned income tax credit recipients from obtaining credit from mainstream lenders. Thirty-one percent of earned income tax recipients who obtained refund anticipation loans had a checking or savings account, compared to a quarter of all refund anticipation customers (numbers not in tables).

Many earned income credit tax recipients that obtained refund anticipation loans had experienced or perceived limitations in credit availability. Nearly half of earned income credit tax recipients that obtained refund anticipation loans reported being turned down or limited by a lender in the last five years, and a little more than half said that they had thought about applying for credit but did not because they thought that they would have been turned down (table A4-3). These percentages are more than two times the percentage of all households experiencing turndowns or limitations and more than three times the percentage of all households perceiving limitations in credit availability.

Table A4-3
Perceptions of Credit Availability of Earned Income Tax Credit Recipients, Refund Anticipation Loan Customers, and All Households
(Percent)

	EITC recipients obtaining RALs	All RAL customers	All households
Turned down or limited in last five years	48.7	46.5	21.8
Did not apply for credit because thought might be turned down	51.5	48.2	14.3

CHAPTER 5
A MODEL OF THE CONSUMER'S DECISION PROCESS

The standard economic analysis of consumer behavior focuses on the outcome of decisions. Such analysis uses a utility optimization model together with data on product choices, prices, consumer income, and perhaps consumers' demographic characteristics to estimate the responsiveness of decisions to differences in prices and income. These analyses have been highly successful in predicting outcomes, but they often provide little insight on the decision process.

To understand the consumer decision process, many researchers have used a cognitive model of consumer decision process, which is often called the buyer-behavior model in the marketing literature (Engel, Blackwell, and Miniard 1997). The acquisition, understanding, use, and retention of information are parts of the decision process. Day and Brandt (1973) first used this model to analyze consumer credit decisions in his study for the National Commission on Consumer Finance. This model has been used in subsequent studies of consumers' decisions on credit generally (Durkin and Elliehausen 1978; Shay and Brandt 1981) and consumers' decisions on specific credit products (Durkin and McAlister 1977; Johnson and Johnson 1998; Lacko, McKernan, and Hastik 2000; Elliehausen and Lawrence 2001). The buyer-behavior model has provided an especially useful framework for assessing regulatory policies in the consumer credit area, many of which address perceived information difficulties faced by consumers (see Day and Brandt 1973; or more recently, Durkin and Elliehausen 2001).

5-1. The Buyer-Behavior Model

The buyer-behavior model views the consumer's decision as a process occurring over several stages: problem recognition, internal and external search for information, choice, and outcome evaluation. These stages are interrelated, with feedback occurring throughout the process. Developments occurring during each stage may cause the process to stop, move to the next stage, or proceed immediately to the purchase.[40] Consumers may simplify, use heuristics, or take shortcuts during the decision process.

Consideration of the decision process suggests several hypotheses about the ways in which consumers use refund anticipation loans:

Problem Recognition

The decision process begins with problem recognition. Demand for credit is a derived demand. It normally arises out of a desire to purchase some good or service. Sometimes a purchase is planned in advance. Other times the desire to purchase occurs because of a perception of a special opportunity or because of an unexpected emergency. For example, consumers may be aware of the availability of refund anticipation loans at tax

[40] Economists also recognize that consumers may not obtain complete information about alternatives before making decisions. In the economist's framework, acquisition of information may be costly. A consumer will acquire additional information only if its expected benefit exceeds the cost. For discussion, see Stigler (1961).

time and plan purchases to coincide with tax filing. Or an opportunity to obtain a refund anticipation loan at tax filing may allow a consumer to proceed with a purchase, reduce credit card debt, or deal with an unexpected emergency.

Internal Search

After the consumer recognizes a problem, the consumer must assess alternatives for action. The assessment begins with a search of stored information and experience. Consumers draw on past experience and are guided by existing attitudes to identify and evaluate alternative solutions to the problem. Several outcomes are possible. A consumer may decide that additional information is needed and search externally. For example, a consumer may recall having seen an advertisement by for a refund anticipation loan and decide to call or visit a tax preparation service. Alternatively, if past experience with a product produced satisfactory results, the consumer may forgo external search and proceed immediately to the purchase stage. Satisfied customers may be able to make intelligent and purposive decisions on the basis of very little information and with little deliberation (Katona 1975; Engel, Blackwell, and Miniard 1997). Thus, a consumer who previously obtained a refund anticipation loan and was satisfied with the experience might decide to obtain another refund anticipation loan without much thought or search for alternatives. Another possibility is that internal search leads the consumer to believe the problem cannot be solved. In this case, the decision process may stop and no purchase is made. For example, a consumer whose credit applications have previously been turned down may take no further action because he believes he cannot obtain credit.

External Search

In this stage of the decision-making process, the consumer uses various sources of external information, such as the mass media (for example, newspapers and magazines), personal sources (for example, friends and relatives), and seller-dominated sources (for example, advertisements and store visits). Before undertaking external search, the consumer may have little or no awareness of the characteristics of available brands or the advantages and limitations of the brands. The consumer may not even know appropriate criteria to use in evaluating alternatives.[41] External search will continue until the consumer believes he has enough information to make purchase and financing decisions.

Consumers differ in their willingness to search. Some consumers are cautious and will search for additional information even when they already have considerable knowledge about alternatives. Other consumers may dislike shopping and will not search very much even if they risk paying too much or not obtaining the preferred set of product characteristics. No matter how disposed a consumer is toward shopping, the willingness to search is limited. Search requires time and energy. At some point, the time and

[41] Evaluative criteria are the product characteristics that the consumer deems to be important in his choice of alternatives. Evaluative criteria are shaped by personality, stored information, and experience. Obviously, a consumer must have some knowledge of the class of alternatives before specifying those characteristics that are important in decision making.

energy required for further search outweigh any expected gains from additional information. The consumer is then ready to make a purchase decision.

Choice and Outcome Evaluation

The purchase decision involves choosing whether or not to acquire the good or service and choosing the variety (that is, the specific set of characteristics) and supplier. The decision process does not necessarily end with the purchase, however. Consumers may continue to process information to evaluate their decisions. An evaluation of the outcome is especially likely when the decision process has been extended. Satisfaction with the purchase decision serves to reinforce existing attitudes and the evaluative criteria upon which they are based. Obviously, satisfaction tends to encourage repeat purchases. Dissatisfaction can lead to revisions in attitudes and a reevaluation of evaluative criteria. In this case, the consumer learns from experience and avoids similar mistakes in the future.

5-2. Information Processing in the Buyer-Behavior Model

Information processing occurs through a psychological command center, which includes both memory and the basic facilities for thinking and directing behavior. The components of the command center necessary for understanding behavior are the information and experience stored in memory, the criteria by which alternative choices are evaluated, and attitudes toward alternatives. Each component is affected by personality. These variables interact to form a filter through which incoming information is processed. The filter plays a critical role in information processing. First, the filter greatly limits the amount of information that comes to the consumer's attention. The filter also may attenuate or distort information to be more consistent with the consumer's attitudes. Finally, the filter limits the amount of information that is retained in memory.

The operation of the filter has important consequences for the evaluation of credit decisions. The consumer must first become aware of the information. The creditor must provide easy access to information, but awareness also depends on the consumer's attitudes and evaluative criteria. A consumer may not become aware of some product characteristics if the characteristics are not important to him. He may focus only on the characteristics that are important to him, especially if the product has many characteristics.

A consumer may be aware of information but not comprehend the information correctly. It is common for information to be attenuated and distorted to be consistent with the individual's own attitudes and experiences. For example, add-on interest rates rather than actuarial rates were commonly disclosed before Truth in Lending. In studies of consumer responses to Truth in Lending shortly after the law became effective, many borrowers recalling annual percentage rates appeared to understand the annual percentage rate as an add-on rate (Shay and Schober 1973; Brandt, Day and Deutscher 1975, for example). This understanding probably reflected consumers' familiarly with add-on rates at that time.[42]

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[42] More recently, Durkin and Elliehausen (2001) reported that borrowers still do not understand the relationship between the annual percentage rate and finance charge. However, far fewer responses suggest

Not all information that is processed is retained in memory. Memory is limited, so the amount of information finally stored will be less than the initial set. Consumers tend to retain the information that is consistent with their attitudes and experience. First-time purchasers of a product might collect more information than previous customers because they do not know what information is important. They tend to retain the information that is useful and consistent with their experiences. Inconsistent or irrelevant information may be forgotten. Thus, new borrowers sometimes appear to be better informed than more experienced borrowers.

5-3. Determinants of the Extent of the Decision Process

Empirical evidence on consumer behavior suggests several different types of factors that may affect the extent of the decision process. They are situational factors, product characteristics, consumer characteristics, and environmental factors.

Situational Factors

Previous research has found several situations in which extended decision processes are likely. Among the situations are ones in which

- The consumer has little or no relevant experience because a consumer has never purchased the product.
- The consumer has no past experience because the product is new.
- Past experience is obsolete because the product is purchased infrequently.
- The purchase is considered discretionary rather than necessary.

Product Characteristics

There are several product characteristics that are associated with extended decision processes.

- Products that commit the consumer for a long period of time.
- Products that are high priced relative to the consumer's income.
- Products having substitutes with both desirable and undesirable characteristics relative to the product.

Consumer Characteristics

Evidence indicates that many socio-economic characteristics of consumers are correlated with the extent of the decision process. Some of the characteristics probably reflect cognitive ability and the opportunity cost associated with search. Others may reflect experience or attitudes. Decision processes are more likely to be extended than limited when

- The consumer has a college education.
- The consumer has moderate rather than high or low income.
- The consumer is under 35 years old.
- The consumer enjoys shopping.

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that the borrowers understand the annual percentage rate as an add-on rate. One explanation for this decline is that consumers are no longer familiar with add-on rates because creditors no longer quote add-on rates.

- The consumer perceives no urgent or immediate need for the product.

Environmental Factors
Environmental factors include family and cultural influences. An extended decision process may be stimulated by differences between a consumer's attitudes and those of his family or one of his reference groups. Thus, consideration of personal characteristics may be justified, even if the characteristics' effects on the decision process cannot always be predicted.

5-4. Refund Anticipation Loan Customers and the Decision Process
Characteristics of refund anticipation loans suggest a few hypotheses about the extent of consumers' decision process. Refund anticipation loans do not commit the consumer for a very long period of time. The refund anticipation loan fee is a small percentage of monthly income, even for many low-income consumers. Refund anticipation loans are not a new product. Consumers may have learned about the product from advertising, newspapers, or the experiences of friends or relatives without making much effort on their own to obtain information. These characteristics are consistent with a limited decision process for refund anticipation loans.

Other determinants of the extent of the decision process are based on the characteristics of the customers themselves. Past experience, need, and personal characteristics such as income, age, and education are empirical questions, which can be addressed through survey methods. Evidence discussed in the previous chapter indicates that while a large percentage of refund anticipation loan customers have low incomes, many have moderate incomes. The majority of customers are under 35 years of age, but quite a large percentage is between 35 and 54. All of these characteristics do not provide unambiguous hypotheses about the extent of the decision process.

Refund anticipation loan customers' credit experience suggests that credit availability may limit many customers' alternatives. More than half of refund anticipation loan customers had a turndown or limitation of a credit application or had thought about applying for credit but did not because they thought they would be turned down. Several other credit characteristics suggest that refund anticipation loan customers' alternatives may be limited. However, since credit is a derived demand, an assessment of the need is incomplete without considering the use of the credit.

CHAPTER 6
THE REFUND ANTICIPATION LOAN DECISION PROCESS

Refund anticipation loan customers do not differ much from tax preparation service customers generally in their reasons of using a tax preparation service. Most cite the complexity of the tax code as the primary reason for using a tax preparation service to prepare their tax returns. Forty percent of refund anticipation loan customers and half of tax preparation service customers mentioned a reason related to the complexity of tax rules as the primary reason for using a tax preparation service (table 6-1).

Table 6-1
Primary Reason for Using Tax Preparation Service
(Percent)

	RAL customers	All tax preparation service customers
Complexity of tax rules		
Tax rules complicated/don't understand rules	14.2	34.0
Don't have time to learn rules/easier for someone else	25.9	15.8
Subtotal	*40.1*	*49.8*
Ability of tax preparer		
Tax preparer less likely to make mistake	18.5	20.1
Tax preparer obtains lower tax obligation	6.9	2.3
Tax preparer is a professional	<0.05	2.2
Subtotal	*25.4*	*24.6*
Processing speed		
Tax preparer able to file electronically	<0.05	0.9
Able to obtain RAL	5.4	0.7
Able to get refund sooner	13.6	6.5
Subtotal	*19.0*	*8.1*
Other		
Always used a tax preparer	11.9	9.7
Tax preparer friend or relative	2.6	3.4
Other	1.1	4.2
Subtotal	*15.6*	*17.3*
Total	100.0	100.0

Many refund anticipation loan customers and tax preparation service customers cited the capabilities of the tax preparer, such as being less likely than the customer to make a mistake or being able to obtain a lower tax obligation. A quarter of both refund anticipation loan customers and tax preparation service customers cited a reason related to the ability of the tax preparer as the primary reason.

Considering refund anticipation customers willingness to pay to obtain funds 8 to 15 days earlier than through electronic filing and direct deposit, it is not surprising that some refund anticipation loan customers gave reasons related to the speed of processing tax returns as the primary reason for using a tax preparer. Nineteen percent of refund anticipation loan customers mentioned reasons related to the speed of processing tax returns. Refund anticipation loan customers were more than twice as likely as tax preparation service customers generally to cite such reasons. Just 8.1 percent of tax preparation service customers mentioned processing speed as the primary reason for using a tax preparation service.

6-1. Choosing a Refund Anticipation Loan

Refund anticipation loan customers were aware of electronic filing, and many considered options for receiving funds from their refund. Virtually all refund anticipation customers knew that their tax preparation service offered electronic filing of tax returns (table 6-2). Nearly two-thirds of refund anticipation loan customers discussed with the tax preparer other options for receiving their refund faster—such as electronic filing and direct deposit—before obtaining a refund anticipation loan. That customers discussed options for receiving refunds is not surprising. Loan applications, information brochures of tax preparers and lenders, and required state and local disclosures provide information about options for filing and obtaining refunds.[43]

Table 6-2
Refund Anticipation Customers' Awareness of Electronic Filing and Consideration of Alternatives for Receiving Refund Faster
(Percent)

	Yes	No	Do not know	Total
Tax preparer offered electronic filing	97.0	2.2	0.8	100.0
Discussed other options for receiving refund faster before obtaining RAL	64.8	32.9	2.3	100.0

Customers obtained refund anticipation loans for a large variety of reasons. A large percentage (41.1 percent) of refund anticipation loan customers said that they obtained refund anticipation loans primarily to pay bills (table 6-3). Twenty-one percent of customers said that they obtained refund anticipation loans because of unexpected expenditures. Most of those mentioning unexpected expenditures cited unexpected expenses (13.7 percent), although a few cited a favorable purchase opportunity (6.7 percent). A small percentage of customers obtained refund anticipation loans to make planned purchases.

[43] For example, see exhibits 2, 3, and 4 in the appendix to chapter 1.

Not having to pay tax preparation fees out of pocket is sometimes mentioned in firms' advertisements for refund anticipation loans. This may be a benefit from a refund anticipation loan, but it is rarely the main reason for obtaining a refund anticipation loan. Customers generally do not have to obtain a refund anticipation loan to pay for tax preparation. Tax preparation services sometimes offer other credit options to customers for payment of tax preparation fees. Some refund anticipation loan customers may be aware of other options for paying tax preparation fees. Less than one percent of customers mentioned paying for tax preparation as the primary reason for obtaining a refund anticipation loan.

Table 6-3
Primary Reason for Obtaining Refund Anticipation Loan

	Percent
Pay bills	
Pay bills from Christmas	12.9
Pay credit card bills (not Christmas)	13.8
Pay other bills, debts (not Christmas or credit card)	14.4
Subtotal	*41.1*
Unexpected expenditures	
Pay unexpected expenses	13.7
Take advantage of favorable purchase opportunity	6.7
Other unplanned purchase	0.8
Subtotal	*21.2*
Purchases	
Make planned purchases	12.9
Other purchases, don't know whether planned	2.0
Subtotal	*14.9*
Other	
Did not want to wait	14.9
School/college expenses	0.6
Vacation	0.9
Pay for tax preparation	0.8
Other	5.8
Subtotal	*23.0*
Total	100.0

While by far most refund anticipation loan customers mentioned a specific purpose, a small percentage of customers expressed impatience as the reason for obtaining a refund anticipation loan. Fifteen percent of refund anticipation loan customers gave as a reason that they simply did not want to wait to get their money. These consumers' preferences may exhibit the very high discount rates that some consumers reveal when they choices involving tradeoffs over a short period.[44]

The greater percentage of refund anticipation loan customers consisted of repeat customers. Seventy percent of refund anticipation loan customers in 2004 had obtained refund anticipation loans in previous years (table 6-4). Nearly three-fourths of refund anticipation loan customers had three or more refund anticipation loans in the past. Apparently many refund anticipation loan customers rely on borrowing against tax refunds to catch up with bills or make large purchases.

Table 6-4
Previous Use of Refund Anticipation Loans

	Percent
First time RAL obtained	29.6
Obtained RAL previously	70.4
Total	100.0
Number of previous RALs	
One	5.5
Two	22.2
Three or more	72.3
Total	100.0

Refund anticipation loans are concentrated at the upper end of the range of loan amounts. Nearly a third of refund anticipation loans were $3,500 or more (table 6-5). Two-thirds were greater than $1,500. Small loans were not very common. Just 5.1 percent of refund anticipation loans were less than $500. The stepped fee schedules used by many lenders may influence the concentration of refund anticipation loans at the upper end. Loan fees tend to be lower relative to loan size at larger loan sizes. Thus, consumers may find larger loans more attractive than smaller loans.

Table 6-5
Refund Anticipation Loan Amounts

	Percent
Less than $500	5.1
$500-999	11.2
$1,000-1,499	16.7
$1,500-2,999	19.7
$3,000-3,499	15.1
$3,500 or more	32.2
Total	100.0

6-2. Awareness of Refund Anticipation Loan Prices

Information on price is necessary for making rational decisions on use of refund anticipation loans. Consumers receive two measures of credit price in credit transactions,

[44] Such behavior has been associated with hyperbolic discounting. For discussion, see Frederick, Loewenstein, and O'Donoghue (2002).

the finance charge and annual percentage rate. They receive the finance charge and annual percentage rate disclosures in Truth in Lending disclosures when the refund anticipation loan is granted. Customers may receive additional state cost disclosures or other cost disclosures in loan applications.

Loan Fee

The finance charge includes the refund anticipation loan fee. The finance charge may also include other fees if they are charged in refund anticipation loan transactions but not cash transactions. Fifty-seven percent of refund anticipation loan customers recalled and reported the dollar amount of the refund anticipation loan fee (table 6-6). In the vast majority of credit transactions, the finance charge is not very useful for making decisions on credit use because as the undiscounted sum of interest payments, it ignores the time value of money. However, refund anticipation loans have such a short term to maturity and are relatively small that discounting does not matter very much.[45] Thus, the finance charge can generally be compared directly with dollar amounts of savings or costs avoided to make a decision. Knowledge of the finance charge does not imply that customers relied on the information to make a decision, but it does indicate that the information was important enough to these customers for them to recall.

Survey-based studies do not allow one to say with certainty whether these reported refund anticipation loan fees are accurate. Previous survey-based studies investigating the effects of information disclosures in consumer credit markets have used an “awareness zone” method to assess consumer reports of credit costs. An “awareness zone” is a range of values that reflects the range of prices charged in the market. Consumers reporting prices within the awareness zone are considered “aware” of the price. Consumers reporting prices too low to be plausible and consumers responding “do not know” are considered to be “unaware.”[46]

Table 6-6
Awareness of Refund Anticipation Loan Fees

	Percent
Reported amount of RAL fee	57.0
Did not know fee	43.0
Total	100.0
Reported fee classified "low" using	
Smaller calculated fee less \$10	9.9
Smaller calculated fee less \$15	6.5
Loans classified as "aware" using	
Smaller calculated fee less \$10	47.1
Smaller calculated fee less \$15	50.5

Fee schedules of two firms are used to create an awareness zone to identify relatively low reported values for refund anticipation loan fees. One fee schedule is the stepped

[45] See discussion of table 3-2 in chapter 3.
[46] For discussion of the awareness zone method, see Shay and Schober (1973) or Durkin (2000).

schedule by loan amount ranges shown in table 1-1. This fee schedule reflects refund anticipation loan fees charged by some of the large lenders in the market. The second fee schedule is a formula that calculates the fee as 3 percent of the loan amount for loans of $333 or more. The fee for smaller loans is $10. The second fee schedule is used for customers of a large tax preparation service.

The two loan schedules were used to calculate fees for each loan based on the reported loan amount. While these schedules likely reflect fees charged for most refund anticipation loans, some lenders may charge lower fees for some loan sizes. Also, some consumers may not respond precisely to survey questions.[47] Thus, the awareness zone is defined as the smaller of the two calculated prices less a small dollar amount to allow for the possibility that a low fee is correct or that the customer responded imprecisely. Estimates of awareness are provided for $10 and $15 deductions from the smaller calculated price.

The results suggest that about half of refund anticipation loan customers were aware of the refund anticipation loan fee. Forty-seven percent were estimated to be aware of the finance charge when the deduction from the smaller price was $10, and 50.5 percent were estimated to be aware when the deduction was $15.

Annual Percentage Rate

The annual percentage rate is the loan fee expressed as a percentage of loan amount multiplied by the number of payment periods in a year. Since the typical term of a refund anticipation loan is 10 or 11 days, the fee percentage is generally multiplied by 36.5 or 33.2. As a consequence, annual percentage rates for refund anticipation loans are quite high.

Table 6-7
Awareness of Refund Anticipation Loan Annual Percentage Rates

	Percent
Reported receiving APR disclosure	26.2

APR disclosed	Percent of those reporting receipt of disclosure
Less than 30%	12.1
30% or higher	3.1
Do not know	84.8
Total	100.0

[47] Consumers may not consult records in responding to questions or make the effort to recall precisely. They often round dollar amounts and provide answers that they consider are good enough. See, for example, Maynes (1968).

Refund anticipation loan customers were not aware of the annual percentage rate for their loans. Only about a quarter of customers recalled receiving an annual percentage rate disclosure (table 6-7). Of those recalling receipt of an annual percentage rate, 84.8 percent said that they did not know the rate that was disclosed. Twelve percent reported annual percentage rates less than 30 percent, rates that clearly were too small to be plausible.

Refund anticipation loan customers' nearly compete lack of awareness of the annual percentage rate on their loan suggests that they are unlikely to have found this information useful in making their decisions. Recall from the psychological model of the decision process that memory is limited. Consumers filter information, storing information that is useful and discarding information that is not.

Awareness of Other Information about the Loan

Refund anticipation loan customers recalled other information on their loans. About three-fourths recalled the tax preparation fee, 67.6 recalled the loan amount, and 86.0 percent recalled the cash advance amount (table 6-8). That a greater percentage of customers recalled the cash advance amount than other information suggests that the receipt of funds from the refund was foremost in their minds. This conclusion is especially pertinent for customers that did not recall the refund anticipation loan fee, for whom the differences in reporting cash advance amounts and other information were particularly large.

Sixty-one percent of refund anticipation loan customers reported both the loan amount and the cash advance amount. This percentage includes about a third of the customers who did not recall a refund anticipation loan fee. Thus, many customers who reported loan and cash advance amounts but not loan fees may have been able to estimate total fees, even if they did not recall the loan fee separately.

Table 6-8
Other Information Reported by Refund Anticipation Customers
(Percent)

Other information reported	All customers	Customers not recalling RAL fee
Tax preparation fee	75.9	55.3
Loan amount	67.6	45.8
Cash advance amount	86.0	74.4
Both loan and cash advance amounts	60.7	33.9

Customers not recalling the refund anticipation loan fee appeared to be aware of options for filing and receiving refunds. Ninety-two percent, of customers not recalling the loan fee were aware that the tax preparer offered electronic filing (number not in table). This percentage is virtually the same as the percentage of all customers reporting that the tax preparer offered electronic filing. Seventy-two percent of customers not recalling the loan fee said that they discussed options for obtaining refunds with the tax preparer (number not in table). These customers' discussions likely focused on the speed of receiving funds or some other feature, not the refund anticipation loan fee.

Refund anticipation loan customers' lack of interest in fees is further indicated by responses to questions about fees deducted from the loan amount. Tax preparation fees and other fees are normally deducted from the refund anticipation loan amount. Customers receive a written itemization of fees charged, often more than one time.[48] Despite receipt of written itemizations, only 47.3 percent of refund anticipation loan customers said that fees other than the loan fee were deducted (table 6-9). More than half of customers apparently did not pay much attention to fee disclosures. Forty-one percent of customers said that no other fees were deducted, and 11.7 percent said that they did not know.

The tax preparation fee was the most frequently mentioned other fee deducted from the loan amount. Of the customers saying that other fees had been deducted, nearly three-fourths reported that tax preparation fees had been deducted. Fifty-four percent mentioned electronic filing fees, and 8.8 percent mentioned some other fee. Eleven percent of customers saying that with other fees had been deducted reported that they did not know what other fees had been deducted.

Table 6-9
Other Fees Deducted from Refund Anticipation Loan Amount

	Percent
Other fees deducted from loan amount	47.3
Other fees not deducted from loan amount	41.0
Do not know	11.7
Total	100.0
Type of fees deducted (percent of customers reporting that other fees were deducted)	
Tax preparation	72.3
Electronic filing	54.3
Other	8.8
Do not know	11.2
Total	(1)

(1) Total is greater than 100 percent because some respondents mentioned more than one reason.

[48] See examples of fee disclosures in the appendix to chapter 1.

6-3. Satisfaction with the Refund Anticipation Loan Decision

By far most refund anticipation loan customers were satisfied with their most recent refund anticipation loan. Fifty-seven percent of customers said were very satisfied, and 28.5 percent were somewhat satisfied (table 6-10). A high level of customer satisfaction with refund anticipation loans can also be inferred by the high frequency of repeat usage, which was observed in table 6-4. Satisfaction with previous experience is often associated with limited and habitual decision processes, in which consumers do not search for or use much information in making choices (Katona 1975; Engel, Blackwell, and Miniard 1997). Such experience may explain some customers' unawareness of the cost of refund anticipation loans.

Table 6-10
Satisfaction with Refund Anticipation Loan

Satisfied	Percent
Very satisfied	56.6
Somewhat satisfied	28.5
Subtotal	*85.1*
Dissatisfied	
Somewhat dissatisfied	7.5
Very dissatisfied	6.4
Subtotal	*14.0*
Don't know	0.9
Total	100.0

Practically all refund anticipation loan customers mentioned the speed at which needed funds were obtained as a reason for satisfaction (table 6-11). These responses provide another indication of the high rate of time preference of refund anticipation loan customers.

Most customers mentioned more than one reason for satisfaction. Over a fifth of satisfied refund anticipation loan customers mentioned loan cost as a factor affecting their satisfaction. Not surprisingly, since they had purchased the product, many of these customers (8.8 percent) believed that the cost was reasonable. However, a larger percentage of satisfied customers (11.2 percent), who were somewhat satisfied, regarded the fees as high. Only a very small percentage of satisfied refund anticipation loan customers (2.5 percent) reported low cost as a reason for satisfaction.

A little more than a third of satisfied refund anticipation loan customers gave convenience as a reason for satisfaction. Eight percent reported "paid tax preparation fee" or "no out of pocket expenses" as reasons for satisfaction, and 9.3 percent reported as reason for satisfaction that the tax preparer explained everything fully.

Table 6-11
Reasons for Satisfaction
(Percent of customers who were very/somewhat satisfied)

	Percent of customers	Percent of reasons
Processing speed		
Received needed money quickly	99.6	44.5
Took longer to get refund	1.7	0.8
Cost		
Reasonable fee/cost	8.8	3.9
Low fee/cost	2.5	1.1
Expensive/high fee	11.2	5.0
Convenience		
Easy/convenient process	34.5	15.4
Little paperwork	2.5	1.1
Paid for fees		
Paid tax preparation fee	2.3	1.0
No out of pocket expenses	5.9	2.7
Information		
Tax preparer explained everything fully	9.3	4.2
Other		
Had to wait to get additional checks	1.7	0.8
Got more money back	7.3	3.2
Was satisfied/had no problems with it	12.5	5.6
Other	18.6	8.3
Do not know	6.8	2.6
Total	(1)	100.0

(1) Total is greater than 100 percent because some respondents mentioned more than one reason.

Of the small percentage (14.0 percent) of refund anticipation loan customers who said that they were dissatisfied with the loan, over two-thirds were dissatisfied because of the high cost of the loan (table 6-12). About half of dissatisfied customers mentioned high fees, and 7.2 percent mentioned high interest rates. Another 11.7 percent of dissatisfied customers mentioned high cost but did not specify whether the high cost was the amount of the fee or the interest rate.

Other frequently mentioned reasons for dissatisfaction involve processing speed and information. Fourteen percent of dissatisfied customers said that they were dissatisfied because the refund took too long. Eleven percent mentioned information problems involving either insufficient or unclear information (8.5 percent) or hidden charges (2.5 percent).

Table 6-12
Reasons for Dissatisfaction
(Percent of customers who were very/somewhat dissatisfied)

	Percent of customers	Percent of reasons
Processing speed		
Took too long	14.0	12.5
Cost		
High fee	51.3	45.9
High interest rate	7.2	6.5
High cost, did not specify whether fee or interest rate	11.7	10.4
Information		
Insufficient/unclear information	8.5	7.6
Hidden charges	2.5	2.2
Other		
Incompetent tax preparer	1.0	0.9
Other	14.3	12.8
Do not know	1.4	1.3
Total	(1)	100.0

(1) Total is greater than 100 percent because some respondents mentioned more than one reason.

In sum, nearly all refund anticipation loan customers were satisfied with their refund anticipation loans. Practically all of satisfied and a small percentage of dissatisfied customers mentioned the time it took to obtain the funds as a reason for their satisfaction or dissatisfaction. It is notable that the high cost of refund anticipation loans was a factor in the evaluation of many customers. In total, 19.4 percent of refund anticipation loan customers mentioned high cost as a reason for being either somewhat satisfied or dissatisfied with their last refund anticipation loan (number not in tables). It is also notable that hardly any customers considered lack of information a factor. Just 1.5 percent of all refund anticipation loan customers mentioned information problems as a reason for dissatisfaction.

6-4. Assessing Customers' Awareness of Loan Prices

The findings on refund anticipation loan customers' awareness of loan prices may reflect more the characteristics of consumers who obtain refund anticipation loans than the availability of information about refund anticipation loan costs. Although many refund anticipation loan customers have at least some education beyond high school, the majority have a high school diploma or less. Forty-two percent of refund anticipation loan customers have a high school diploma, and about 21.9 percent have not completed high school (table 6-13). These percentages are greater than the percentages respondents in all households that have a high school diploma (33.5 percent) or have not completed high school (16.0 percent).

Table 6-13
Education of Refund Anticipation Loan Customers
(Percent)

	RAL customers	All households
Less than high school diploma	21.9	16.0
High school diploma	42.4	33.5
Some college or technical school	25.7	25.5
College degree	8.4	16.6
Graduate school	1.6	8.4
Total	100.0	100.0

Previous research investigating awareness of annual percentage rates indicates that for both closed-end and open-end credit, awareness of annual percentage rates is positively related to the level of education (Day and Brandt 1973; Durkin and Elliehausen 1978; Shay and Brandt 1981). Durkin and Elliehausen (1978), for example, found that 40.6 percent of consumers with less than a high school diploma were aware of annual percentage rates for closed-end credit in 1977, compared to 53.1 percent of consumers with a high school diploma and 64.7 percent of consumers with some college or more. Levels of awareness of annual percentage rates were higher for bank cards than for closed-end credit at all levels of education. Nevertheless, barely half of consumers with less than a high school diploma were aware of annual percentage rates for bank cards at that time.

Shay and Brandt (1981) considered the effect of education on consumer awareness of both annual percentage rates and finance charges on a hypothetical closed-end loan. They found a positive relationship between the awareness of credit costs and the number of years of education. They also found that consumers who were aware of annual percentage rates had on average more years of education than consumers who were aware of finance charges but not annual percentage rates.

Evidence of refund anticipation customers' awareness of bank card rates is consistent with the view that that awareness of refund anticipation loan costs may reflect more the characteristics of consumers who obtain such loans than the availability of information. Refund anticipation loan customers who had a bank card were asked to report the annual percentage rate charged on the bank card that they used most frequently. Twenty-six percent these customers responded that they did not know (table 6-14). This percentage is about two and a half times greater than the percentage for all households with bank cards that said they did not know.

Refund anticipation loan customers were also more likely than all households to report rates that are too low. Twenty-five percent of refund anticipation loan customers with bank cards reported rates less than 7.50 percent, compared to just 5.4 percent of all households with bank cards. These results suggest that many refund anticipation loan customers are generally unaware of credit costs, not just unaware of refund anticipation loan costs.

Table 6-14
Annual Percentage Rate on Most Frequently Used Bank Card
(Percent of consumers with bank cards)

	RAL customers	All households
Less than 7.50 percent	24.6	5.4
7.50-11.49 percent	13.3	12.9
11.50-14.49 percent	13.0	16.8
14.50-19.49 percent	11.0	41.0
19.50 percent or more	12.4	14.0
Do not know	25.7	10.0
Total	100.0	100.0

Discussing consumers' general lack of awareness of interest rates, Juster and Shay (1964) noted that many consumers' real borrowing rates are greater than market rates. These consumers may not be aware of the interest rate because it is not relevant to their credit decisions. Their credit choices may be limited because of institutional features of credit markets designed to control default risk. As a result, they may find themselves forced to borrow from themselves by reducing current consumption to repay debt, at a cost that depends on their rate of time preference for present versus future consumption. Evidence presented earlier in this monograph suggests that many refund anticipation loan customers do face limitations in availability of credit and have high rates of time preference, which characterize rationed consumers. That refund anticipation loan customers are unaware of annual percentage rates for such credit is not especially surprising.

Although most refund anticipation loan customers recalled some information about fees, many did not recall the amount of the refund anticipation loan fee. It seems likely that the decision process for many consumers was limited and that the refund anticipation loan fee did not play a very large role in the decision. More than half of refund anticipation loan customers used the loan to catch up with bills or to make an unexpected expenditure. Coupled with limited availability of credit from other sources, these uses suggest that consumers' viewed the transaction as necessary. The refund anticipation loan fee generally is a small percentage of both the customer's monthly income and the amount of the loan. Thus, the fee does not appear as a major obstacle to obtain the loan. Moreover, many customers had obtained refund anticipation loans in the past and considering satisfaction with the most recent loan, likely were also satisfied with past experience. These conditions suggest a decision process with little information gathering or deliberation. As mentioned, information that is not very important to a decision often is not retained in memory. Some customers may have been unable to recall the amount of the refund anticipation fee because the fee was not important to them.

6-5. Summary

Refund anticipation loan customers do not differ much from tax preparation service customers generally in their reasons of using a tax preparation service. Most cite the complexity of the tax code or the ability of the tax preparer as the primary reason for using a tax preparation service. Only a small percentage of refund anticipation loan customers cited the availability of refund anticipation loans as a reason for using a tax preparer.

Most refund anticipation loan customers provide evidence of some deliberation in choosing to obtain a refund anticipation loan. Nearly all customers were aware of electronic filing, and more than half of customers discussed with the tax preparer other options for getting funds from refunds faster. About half of customers recalled the refund anticipation loan fee, and most customers recalled some other information about the loan.

However, it is clear that many refund anticipation loan customers did not deliberate very much. That half of customers did not recall the refund anticipation loan fee suggests that loan price was not a very important consideration for a large percentage of customers in their decision to obtain a refund anticipation loan. Receipt of funds seemed to be foremost in refund anticipation customers' minds. By far most customers recalled the cash advance amount, including three-fourths of customers who were unable to recall the loan fee.

In many situations, characteristics that often lead to limited decision processes were present. For example, many refund anticipation loans may have been obtained to resolve urgent needs. More than half of customers used obtained the loan to pay bills or make unexpected expenditures. Perhaps more significant is that a large percentage of refund anticipation loan customers may have relied on previous experience in making decisions. About one in seven customers had obtained refund anticipation loans previously. By far most of these customers had obtained three or more loans in the past. Consumers with ample previous experience are often in a position to make purposeful and intelligent decisions without much deliberation.

By far, most customers were satisfied with their most recent refund anticipation loan. Practically all satisfied customers mentioned quick receipt of funds as a reason for satisfaction, a response that is consistent with the conclusion that receipt of funds seemed to be foremost in refund anticipation customers' minds. It is notable that about one in nine satisfied customers expressed satisfaction despite their perception that the refund anticipation loan was expensive. In addition, the perception that the refund anticipation loan was expensive was commonly the reason for dissatisfaction. About seven in ten dissatisfied customers mentioned the high cost of refund anticipation loans as a reason for dissatisfaction.

CHAPTER 7
CONCLUSIONS

This study uses an economic model of the credit decision and a psychological model of the decision process as a framework for analysis of consumers' use of refund anticipation loans. The economic model focuses on the outcome of decisions. The model predicts that some consumers may benefit from relaxation of limits on the amount they can borrow, even if they pay a high cost to obtain the additional credit. Such consumers tend to be in early stages of the family life cycle. They are young and have children. Their stock of household durables may be relatively low, and returns on additional household investment may be high. Consumers in this situation often seek to borrow to finance the acquisition of additional household investment, but their ability to borrow may be constrained by their limited current resources. Most credit products are not intended to allow a consumer to borrow fully against an uncertain future income. However, there are a few high cost products that permit borrowing beyond customary limits. The refund anticipation loan, which permits a consumer to borrow against an expected tax refund, is such a product. One would expect that refund anticipation loan customers would be largely from the credit constrained group.

Consistent with the predictions of the economic model, by far most refund anticipation loan customers in 2004 were in early life-cycle stages in which returns on household durables and consequently demand for credit are high. Furthermore, refund anticipation loan customers were generally in lower or moderate income groups, which have limited resources for servicing additional debt. They disproportionately had incomes in lower middle-income groups between $15,000 and $39,999. In contrast, refund anticipation loan customers were less than proportionately represented in upper middle and higher income groups that typically are not credit constrained.

An examination of refund anticipation loan customers' use of other types of credit supports the conclusion that many refund anticipation loan customers' access to additional credit is limited. Customers typically fell into one of two groups. The first group consists of consumers who were more likely to use closed-end consumer credit and have higher consumer debt payments relative to income than all households. Relatively high debt payment burdens may limit these customers' access to additional credit. The second group consists of customers who did not have a bank account. Customers without a bank account may have difficulty qualifying for credit at many lenders.

Refund anticipation loan customers were less likely than other consumers to have open-end bank credit card accounts against which they can borrow at their discretion. A considerable percentage of customers who had bank credit cards reported that there were times during the last year when they did not use their bank credit cards because they would have exceeded their credit limits. Thus, open-end credit may not be an option for short-term borrowing.

About a quarter of refund anticipation loan customers had serious delinquencies on mortgage or consumer debts in the previous year, a characteristic that limits access to credit. Nearly half of customers had been turned down or offered less credit than they had applied for in the previous five years. About half of customers thought about applying for credit but did not because they thought that they would be turned down. The incidence of serious delinquency, loan turndowns or limitations, and perceptions of limitations is much higher among refund anticipation loan customers than the population as a whole.

In sum, refund anticipation loan customers generally have life-cycle characteristics and income that are associated with credit rationing. Their credit market experiences indicate that many customers are indeed constrained. Economic theory predicts that such consumers may benefit from a relaxation of credit constraints. Many such consumers turn to a variety of high-cost credit sources for the additional credit. Survey responses do not allow one to determine whether these customers made utility-increasing decisions. However, there are plausible circumstances in which the net present value of a refund anticipation loan would be positive and, therefore. utility increasing. Refund anticipation loan customers are not very often from groups that economic theory predicts would not benefit from use of high-cost credit.

The psychological model focuses on the process of decision making. Decision making is a multiple step process involving problem recognition, information gathering, choice, and outcome evaluation. Many factors influence the influence extent of this process. These factors include circumstances of the situation, product characteristics, consumer characteristics, and environmental influences. Decisions tend to be extended when the consumer has little previous experience or knowledge of the product, the consumer perceives no immediate need for the product, and the product is relatively expensive or commits the consumer for a long period of time. In contrast, the decision process tends to be limited when the consumer is satisfied with past experience with the product, the consumer perceives an urgent need for the product, or the price of the product is low relative to the consumer's income. Consumers with college educations tend to have more extended decision processes than consumers with less than college educations.

Although many refund anticipation loan customers provide evidence of deliberation in their decision to use a refund anticipation loan, a large percentage of customers appear to have used a limited decision process. As mentioned, circumstances of the situation, product characteristics, and consumer characteristics all may contribute to limited decision processes.

By far most refund anticipation loan customers used the refund anticipation loan to resolve a specific problem, usually an urgent problem such as paying bills or making an unplanned purchase. A perception of urgency may incline many of these customers to a limited decision process. A small percentage of customers used refund anticipation loans to make a planned purchase. Another small percentage of customers did not mention a specific problem that the refund anticipation loan was intended to resolve. Customers not mentioning a specific problem gave not wanting to wait for their money as the primary reason for getting a loan.

Characteristics of the refund anticipation loan may also contribute to a limited decision process for some consumers. The dollar amount of the refund anticipation loan fee is low relative to most customers' monthly income and relative to the larger loan amounts. For a relatively small dollar fee customers can obtain a loan to resolve a problem. The debt is then normally liquidated after a short period of time—only 10 to 14 days—without effort by the customer.

In many cases, the decision to obtain a refund anticipation loan may have become routinized. Seventy percent of refund anticipation loan customers in 2004 had also obtained refund anticipation loans in previous years. By far the greater percentage of these customers had three or more refund anticipation loans. High satisfaction with the most recent loan in 2004 loan suggests that these customers likely were also satisfied with refund anticipation loans in previous years. By far most of refund anticipation loan customers were satisfied with the most recent loan. Consumers having ample previous experience and satisfaction with that experience often make subsequent decisions with little or no information gathering or deliberation.

Consumers do receive information on the cost of refund anticipation loans and options for receiving funds from tax refunds. Nearly all customers said that their tax preparation service offered electronic filing, and nearly two-thirds discussed alternatives for obtaining refund anticipation loans faster before obtaining a refund anticipation loan. About half of customers reported an amount of loan fee that suggests that they were aware of the dollar cost of their refund anticipation loan. Most customers recalled other information about the transaction, such as loan and cash advance amounts or whether other fees were deducted from the loan amount. Thus, many customers provided evidence suggesting consideration of information and deliberation in their refund anticipation loan decisions.

Responses of other customers suggest that a large percentage of refund anticipation customers may not proceed with much information search or deliberation in choosing a refund anticipation loan. About half could not recall the refund anticipation loan fee or reported an amount that was too low to be plausible. Many of these customers reported other information about the transaction, such as the tax preparation fee, the amount of the loan, or the amount received. About a third of those not recalling a refund anticipation loan fee reported both loan and cash advance amounts. Customers not recalling the loan fee received information on fees and may have considered fee information in their decisions. However, their inability to recall this information suggests that the refund anticipation loan fee likely was not a very important consideration in their decision.

If a lack of awareness of the cost is a problem for some refund anticipation loan customers, the problem is not unique to the refund anticipation loan product. About half of refund anticipation loan customers with bank credit cards were unaware of the annual percentage rate for their most frequently used bank card. Refund anticipation loan customers' awareness of loan costs likely reflects the characteristics of consumers who obtain refund anticipation loans rather than availability or comprehensibility of information. Refund anticipation loan customers disproportionately have less than 12 years education or a high school diploma, education levels that previous research indicates have lower awareness of credit costs generally than consumers overall.

Concern about levels of awareness of refund anticipation loan fees may be mitigated by several considerations. First, refund anticipation loan customers typically are credit constrained. Economic theory indicates that for such borrowers the cost of forgoing current consumption or using precautionary holdings of liquid assets may be the appropriate discount rate for evaluating consumption/investment decisions. If the cost of credit is not used in making a decision, the cognitive model of the decision process suggests, the information may not be retained in memory. Second, many customers also obtained refund anticipation loans in previous years, most often more than once. Previously satisfied borrowers may be in a position to make decisions without information gathering or deliberation. Again, if borrowers do not use the cost information in their most recent decision they may not retain the information. Finally, information about refund anticipation loan fees and alternatives for filing and obtaining funds faster is readily available. Customers were aware of the availability of electronic filing; and most customers, including customers not recalling the loan fee, discussed with the tax preparer alternatives for obtaining funds faster. Hardly any refund anticipation loan customers perceived unclear or insufficient information or hidden fees as problems.

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